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Article

"China's new course: Strengthening private consumption": Five questions to Christian Dreger

DIW Economic Bulletin

Provided in Cooperation with:

German Institute for Economic Research (DIW Berlin)

Suggested Citation: Dreger, Christian; Wittenberg, Erich (2014) : "China's new course: Strengthening private consumption": Five questions to Christian Dreger, DIW Economic Bulletin, ISSN 2192-7219, Deutsches Institut für Wirtschaftsforschung (DIW), Berlin, Vol. 4, Iss. 2, pp. 7-

This Version is available at:

<https://hdl.handle.net/10419/92928>

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Prof. Dr. Christian Dreger, Research Director International Economics in the Department of Macroeconomics at DIW Berlin

FIVE QUESTIONS TO CHRISTIAN DREGER

»China's New Course: Strengthening Private Consumption«

1. Professor Dreger, the Chinese economy has experienced tremendous growth in recent years sustained by successful exports. Now the government is setting a new economic course toward private consumption. What is to change? In recent years, China has grown mainly through its exports and investments. The vulnerability of this model was exposed during the global financial crisis. In 2009, exports fell by approximately ten percent. Nevertheless, China was able to maintain its strong GDP growth because the government responded with a gigantic fiscal stimulus package. This has, however, reinforced existing imbalances in the country. To achieve a path toward more sustainable growth, China is attempting to strengthen the importance of its domestic economy. In recent years, the focus of economic policy has not been on the consumer and, in fact, the consumption ratio has also fallen. It is now at only 35 percent. Although consumption has grown, it has done so less than GDP.
2. What measures is the Chinese government planning? We know that cities tend to consume more than rural areas. As a result, economic development is being promoted through greater urbanization. Of course, the Chinese government also knows that it needs to liberalize the financial markets further to ease liquidity restrictions on households. At the same time, the aim is to reinforce the importance of the renminbi as an international reserve currency. China is now the second major country in the global economy and will overtake the US in a few years' time; it is therefore incongruent that the renminbi should only play such a regional role.
3. Do ordinary Chinese citizens actually have enough money to consume more? In recent years, disposable incomes have increased, often quite significantly. One main problem is the high savings rate which has continued to grow in recent years. There are a variety of reasons for this development, including inadequate social security, liquidity constraints, which impact on many households, or the lack of access to urban services for households registered in rural areas.
4. What impact could China's new course have on the global economy? The global economy ought to benefit from China focusing more on domestic growth because China would then have to import more goods. This is a normal development for a country integrating more into the global economy. The question is how will China achieve this transformation? There is overcapacity in the investment sector which, in the past, was encouraged by less restrictive lending by banks. Many loans are certainly beyond recovery. This represents a significant risk to the national budget. In altering its economic course, China faces considerable challenges and it is not even clear whether this reform process will be successful.
5. How great is the risk? It remains to be seen how much bad debt there actually is. While it has fallen since the turn of the millennium, the country's vulnerability further increased during the financial crisis because most state-owned banks gave loans to state-owned enterprises without any credit checks. Ultimately, if the enterprise goes bankrupt, the government will jump in, increasing public debt. Generally, the Chinese government's response to the financial crisis has actually delayed the necessary transformation toward a higher weighting of the private sector. But this kind of change is imperative to achieve high growth rates in future.

Interview by Erich Wittenberg.

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Volume 4, No 2
14 February, 2014
ISSN 2192-7219

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