

**An Overview of**  
**“A New Economic Growth Engine for  
China: Escaping the Middle Income  
Trap by NOT Doing More of the Same”**

**Wing Thye Woo (胡永泰)**

Fudan University, Shanghai

Columbia University, New York City

Brookings Institution, Washington D.C.

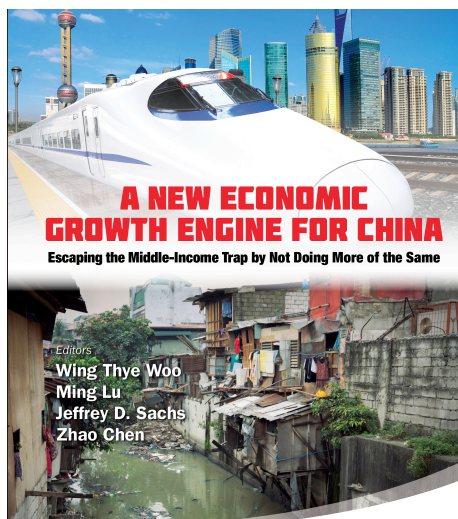
Penang Institute, George Town

University of California, Davis

Central University of Finance and Economics, Beijing

[wtwoo@ucdavis.edu](mailto:wtwoo@ucdavis.edu)

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Escaping  
the Middle-Income Trap  
A Perspective on China's Sustainable Economic Growth  
跨越“中等收入陷阱”  
展望中国经济增长的持续性

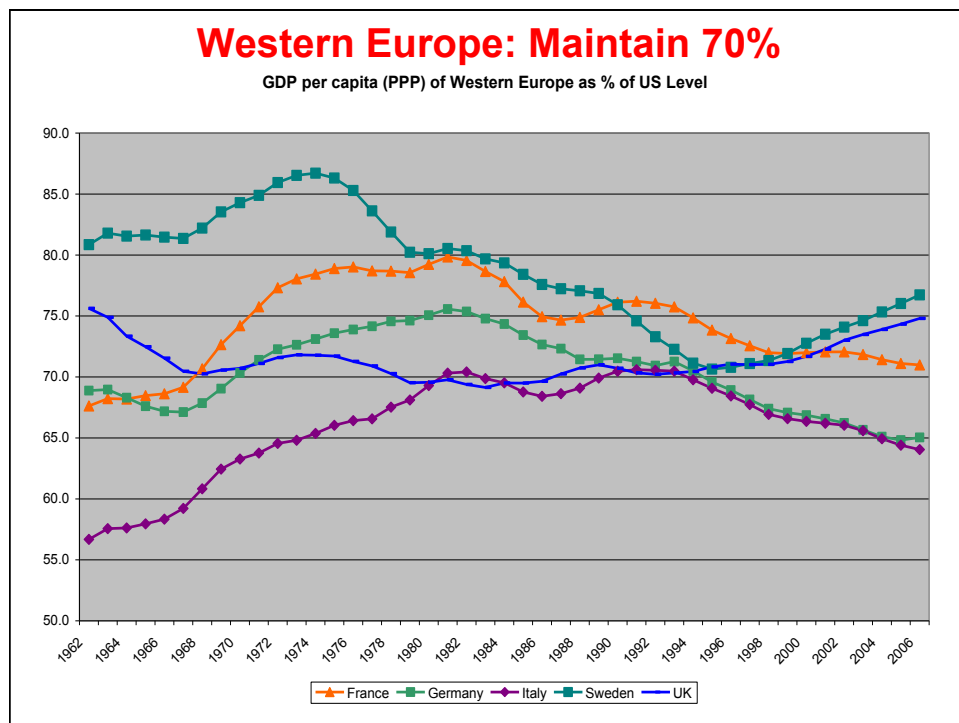
## Historical Perspective and Definition

- In 2012, China has been the fastest growing country in the world for 35 years.
- In 1912, what is the country that had been the fastest growing country in the world for the last 35 years? What is its position today?
- When do we know that a country is caught in the middle-income trap? ***The country shows no tendency to converge to the living standard of the global economic leader, e.g. it stays at 50% of the living standard of the global leader for 20 years or more!***

## Catch-Up Index (CUI)

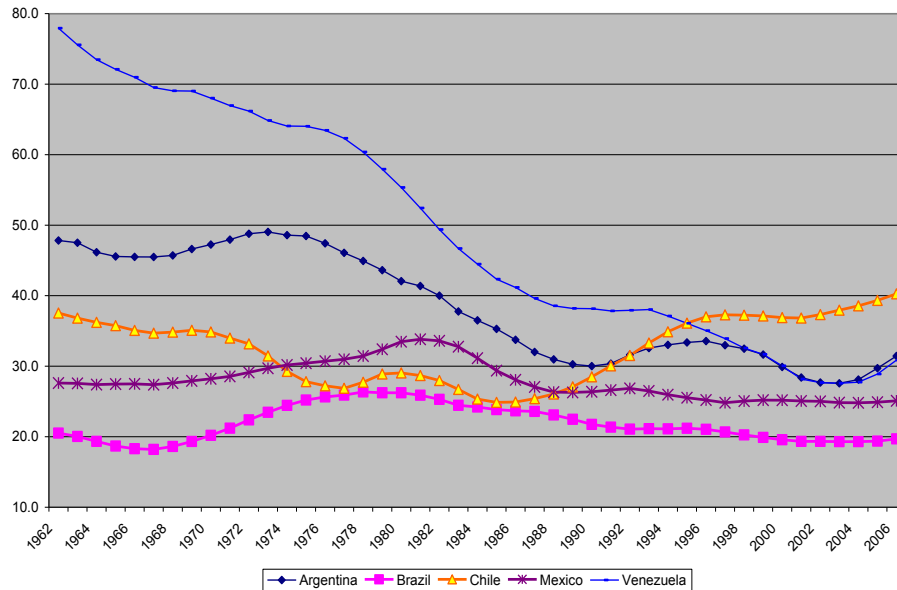
- CUI = country's income level / US income level
- boundaries of income group is based on notion that most of Western Europe is high-income and most of sub-Saharan Africa is low-income,
  - CUI >55% for high-income,
  - CUI <20% for low income
  - 1960: 20 countries high, 32 middle, 80 low
  - 2008: 27 countries high, 24 middle, 81 low
  - ***China entered middle-income in 2006***

# Club Convergence in Largest Economies in Western Europe (High-Income Club) and in South America (Middle-Income Club)



## Latin America: Stuck at 30%

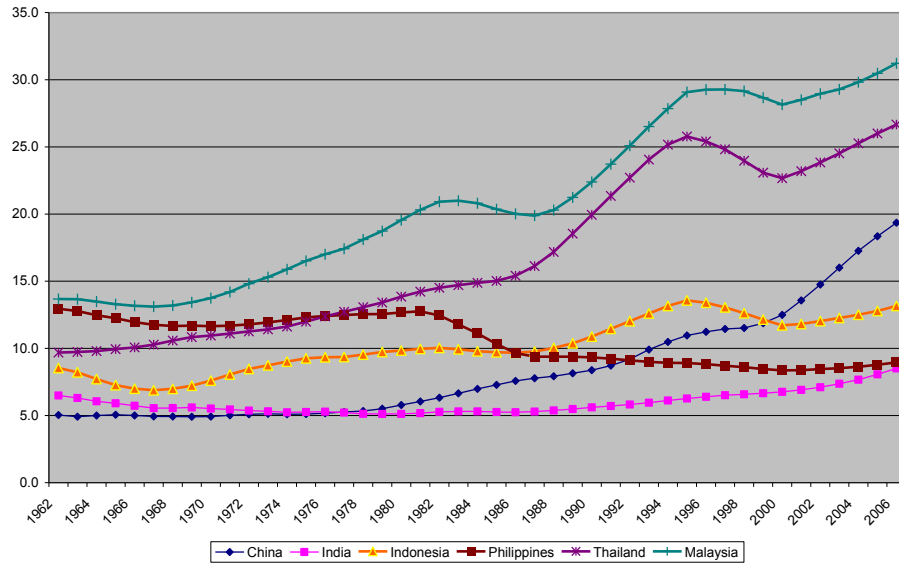
GDP per capita (PPP) of Latin America as % of US Level



**Is Divergence the Norm in the  
Largest East Asian  
Economies? Go Malaysia!**

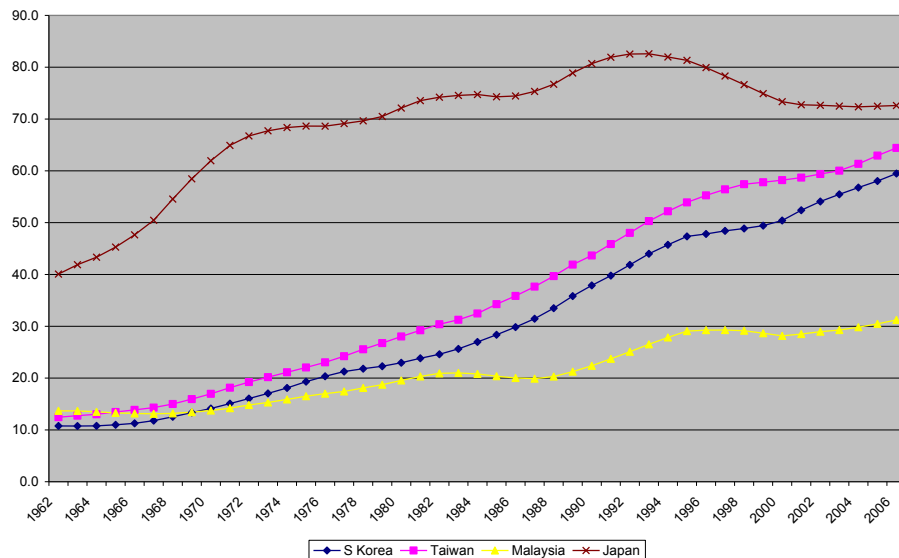
## Developing Asia: Moving Along, Now 20%, Malaysia and Thailand are the best performers

GDP per capita (PPP) of Asia-6 as % of US Level



## “High-Performer” Malaysia was richer than South Korea and Taiwan in 1965 – wallowing in middle-income trap since 1996. China to become 2nd Malaysia?

Japan, S. Korea, Taiwan and Malaysia: Living Standard as % of USA Living Standard



### 3 of the messages in the book:

- Catch-up momentum is difficult to maintain because just doing more of the same does not work e.g. Soviet catch-up via heightened investment
- Stage-specific obstacles to moving up e.g. during earliest catch-up stage, economic reforms much more important than socio-political reform
- Domestic policy must be in line with international economic environment; and must change along with it

### China as a Speeding Car: Types of Potential Crashes

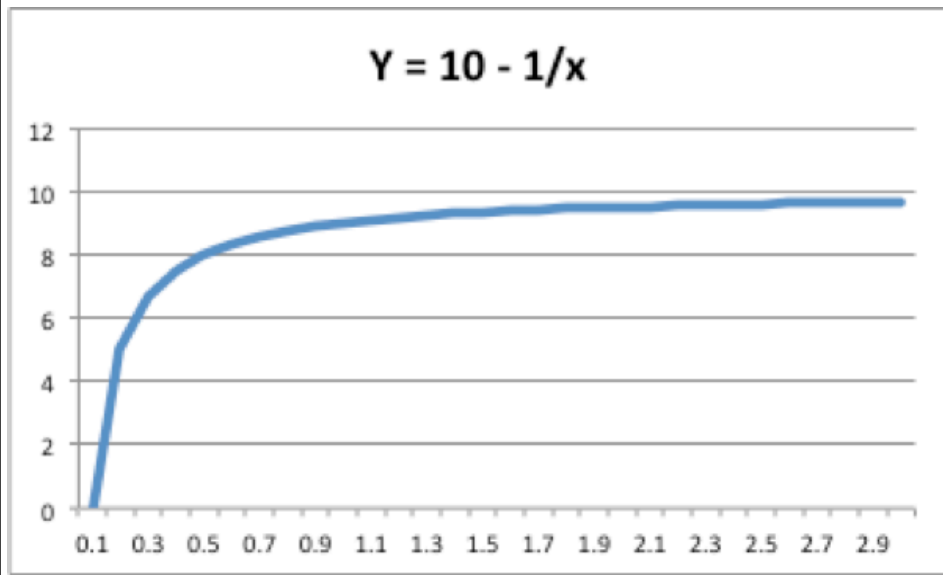
- Hardware failure (**wheel comes off**): failure in economic mechanism, e.g. banking sector collapse, fiscal mismanagement
- Software failure (**a fight inside the car**): failure in governance, e.g. corruption, incompetence
- Power supply failure (**run out of gas or hit a road block**): failure in environmental management or failure in managing foreign economic relations, e.g. water shortage, trade sanctions
- Interpreting *Hexie Shehui* software failure is the most probable

## Relationship among the 3 types of failures: The Anna Karenina Principle

- Leo Tolstoy in opening of Anna Karenina: “Happy families are all alike; every unhappy family is unhappy in its own way.”
- Which is the correct translation of Tolstoy?
  - a.  $Y = X_0 + aX_1 + bX_2 + cX_3$
  - b.  $Y = X_0 X_1^d X_2^e X_3^f$

where  $Y$  = level of happiness,  
 $X_i = 0 \rightarrow$  Failure  $i$  has occurred  
 $X_i > 0 \rightarrow$  Degree to which Failure  $i$  is being successfully addressed
- Needs whole package to work, needs the whole package to work. Existence of prerequisites, no substitutability

## A Policy Exhaustion Scenario: $Y = X_0 - a/X_1 - b/X_2 - c/X_3 + (X_1^d X_2^e X_3^f)$



### **China should adopt a new paradigm in:**

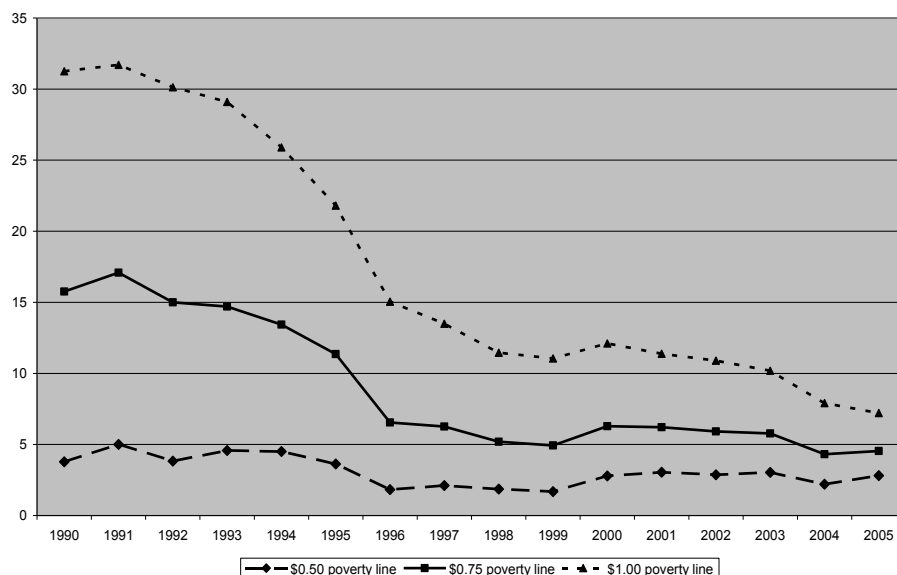
- **Yuan Zhigang on demand-management** e.g. no 2008 style macro-stimulus for the 2012 slowdown
- **Chen Zhao and Lu Ming on urbanization strategy** e.g. reduce discrimination against the largest cities like Shanghai & Tianjin
- **Feng Jin and He Lixin on pension system** e.g. build a sustainable financing mechanism
- **Zhang Yan on fiscal system** e.g. an efficient central-local fiscal arrangement
- **Zhang Liqing on financial sector** e.g. small-medium private banks
- **Klaus Lackner, Sarah Brennan, Cai Ximing and Upmanu Lall on energy and water management** e.g. international coordination and virtual water flow

**Needed to prevent Software Failure: Improvement in Socio-Political Governance**



## Trickling Down is now weaker, Extreme Poverty is Entrenched

Proportion of Rural Population Below Poverty Line (%)  
The poverty line is measured in 1985 PPP US\$



## Income Distribution Worse than the Already Bad Picture from govt data

Category	% of urban residents	Official income (RMB)	"True" income (RMB)	Distribution of hidden income (%)
Lowest income	10	4,754	5,350	0.4
Low income	10	7,363	7,430	0.0
Lower middle income	20	10,196	11,970	2.3
Middle income	20	13,984	17,900	5.1
Upper middle income	20	19,254	27,560	10.9
High income	10	26,250	54,900	18.8
Highest income	10	43,614	139,000	62.5
<i>All urban dwellers</i>	<i>100</i>	<i>16,885</i>	<i>32,154</i>	<i>100.0</i>

### **A New Vision Unveiled in 2006**

- October 2006, new CPC objective was to build a harmonious society, *hexie shehui*, defined as
  - a democratic society under the rule of law
  - a society based on equality and justice
  - an honest and caring society; and
  - a stable, vigorous and orderly society
  - a society in which humans live in harmony with nature
- **Problem identified:** China is not heading toward a harmonious society
- **Solution:** Adopt *kexue fazhan guan* to increase accountability of the state to induce better performance

**Needed to Prevent Power  
Supply Failure: A New  
Approach to External Trade  
and Diplomatic Relations**

## Harmonious Foreign Relation

- Because domestic Chinese economic development has large impact on other *major* countries, it is not possible for China to build a harmonious society without also having to help build a harmonious world

**Problem: China has a “harmonious society” mindset but not a “harmonious world” framework. China reacts and does not take initiatives to provide global public goods.**

**Solution: Internationalise *Hexie Shehui (Harmonious Society)* Principle to have parallel *Hexie Shijie (Harmonious World)* Principle, e.g. take leadership role in pushing**

- Doha Round forward
- Global Accord on Climate Change

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