

How big is the Chinese economy?

By Keith Bradsher

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HONG KONG: How big is the Chinese economy?

New calculations by the World Bank, suggesting that the Chinese economy may not be as large as previously thought, are setting off a debate among economists over whether the calculations are accurate and what they should mean for the West's currency policies toward China.

The World Bank issued preliminary figures Monday that recalculated what would be the economic output of 146 countries - including China - after excluding differences in domestic prices and currencies.

The so-called purchasing-power-parity calculations, which compare the buying power of citizens around the world, showed that China's output was 40 percent smaller than previous World Bank estimates.

The calculations help to explain how Chinese workers can make ends meet by earning \$100 to \$250 a month in export-oriented factories in Shenzhen, China. A large plate of fried rice in a cheap Shenzhen diner can cost just 50 cents.

Fashionable streets even in inland cities like Chongqing now have stores selling Burberry raincoats and other luxury gear to the country's emerging elite. But the new World Bank calculations underline the extent to which China remains a poor nation over all.

The average Chinese has an economic output worth \$1,721 at China's low market prices. That works out to the buying power of someone consuming \$4,091 worth of goods and services valued at the prices of an industrialized economy - a level of consumption that would leave an American struggling in poverty.

The World Bank declared Monday that prices in China were closer to world levels than it had previously assumed. So the bank calculated that the purchasing power parity of China's economy was closer to the market exchange value than previously thought.

The World Bank cautioned that it did not calculate its figures as a guide to currency values. The bank's new figures nonetheless strengthen somewhat Beijing's contention that the Chinese currency, known as the yuan or renminbi, is not seriously undervalued and does not need to be allowed to rise sharply against Western currencies.

Jeffrey Frankel, the James Harpel professor of capital formation and growth at Harvard University, has been one of the most outspoken advocates of yuan appreciation. He has cited the World Bank's purchasing-power-parity calculations to justify his position.

He acknowledged in a telephone interview Thursday that the new World Bank figures badly damaged that argument. "I would have to retract that based on these latest numbers," he said.

But Frankel said that many other economic indicators still show the yuan is somewhat undervalued and should be allowed to rise. He cited China's massive and growing trade surplus, its ever-rising foreign exchange reserves, market speculation on yuan appreciation and signs that the economy may be overheating as exports soar.

Some economists, including the former head of the China division at the International Monetary Fund, question whether the World Bank has now overstated prices in China. While describing the estimates as an important step toward making international comparisons of economies, they note that the bank looked mainly at affluent cities in coastal provinces with big export industries.

China's economic output in 2005 was worth \$2.24 trillion at prevailing prices and actual market exchange rates. That is the calculation most commonly used by economists and the best indicator of a country's

ability to buy and sell internationally traded products, from oil to steel to computers.

The World Bank had previously calculated that China's output was worth \$8.8 trillion in 2005 if the goods and services produced were valued at American prices. This figure was revised this week down to \$5.3 trillion.

Even with the revision, China is still the world's second-largest economy in purchasing-power-parity terms, after the United States. At market exchange rates, it also trails Japan.

Eswar Prasad, who was the China division chief at the International Monetary Fund until last January and is now the Tolani senior professor of trade policy at Cornell University, described the World Bank calculations as a "heroic effort." But he voiced misgivings about how the bank accounted for price differences between urban and rural areas and among regions of China.

The bank used data that the Asian Development Bank had obtained from the Chinese government's National Bureau of Statistics, which in turn gathered data in the administrative regions of 11 large, mostly prosperous Chinese cities. The World Bank calculated prices for the three-fifths of China's population who live in rural areas by using prevailing prices in agricultural areas at the fringes of the 11 cities.

While the World Bank made some adjustments, Prasad questioned whether the final figures still overstated average rural prices across all of China. This would then understate the true size of China's economy.

"The notion that China is suddenly a much smaller part of the world economy should be taken with a huge degree of caution," he said.

But Prasad acknowledged that the World Bank needed to update its purchasing-power-parity figures for China. The bank's figures had previously been based on prices first calculated by two Chinese economists in 1986 and only crudely updated for inflation since then.

Frederic Vogel, the World Bank economist who oversaw the purchasing-power-parity estimates, said the China calculation "depends on a basic assumption that prices from the rural areas of the 11 administrative areas are representative of rural China."

But he noted that most countries, including the United States, mainly measure prices in urban areas, so international comparisons are still valid.

Vogel said the figures released Monday were preliminary and could be subject to further revision this winter but added that "the data we provided this time really form a benchmark."

The best-known calculations of purchasing power parity outside of the World Bank's are performed at the University of Pennsylvania. Alan Heston, a professor emeritus of economics at the university and the co-director of the group that assembles the statistics, said the university's figures for China were slightly below the old World Bank estimates and far above the new figures.

But he cautioned that the university was reviewing its figures and was likely to lower them. The revised estimate will show the Chinese economy to be at least as large as the new World Bank calculation and quite possibly larger, he said.

Beijing raises interest rates

The Chinese central bank raised interest rates Thursday for the sixth time this year in seeking to cool a surge in prices, The Associated Press reported from Beijing.

The bank said the interest charged on a one-year loan would rise by 0.18 percentage point to 7.47 percent, effective Friday. Rates on bank deposits will rise by 0.27 percentage point to 4.14 percent.

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