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Unlocking the power of Chinese consumers: An interview with Stephen Roach

Morgan Stanley Asia's chairman discusses the roots and prospects of China's next revolution.

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In China's rush to join the global economy, the country stoked exports and government-led investment but neglected to build social and economic institutions needed to encourage consumers at home. Stephen Roach, Morgan Stanley Asia's chairman, says it's time for the world's fastest-growing economy to find a "back-up plan." This interview was conducted by Clay Chandler, the McKinsey publishing group's Asia editor, in Hong Kong in August 2009. Watch the video, or read the transcript below.



Video: Unlocking the power of Chinese consumers

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Clay Chandler: We're talking today with Steve Roach, the chairman of Morgan Stanley Asia. Steve has been here in Hong Kong for nearly two years now but is known to many for his previous role as Morgan Stanley's chief economist. He's a long-time observer of the global economy and of economic policy and development in China. Steve, thank you for being with us.

Stephen Roach: I'm delighted to be here.

Clay Chandler: Private consumption is running at about 36 percent of GDP in China right now. That is half of the US consumption rate, and it's about two-thirds of the consumption rate of Europe. It has come down very dramatically in the last decade, and tested levels that we've really never seen in any other major economy in the history of the modern global marketplace. Why is China's consumption so low, and how do you explain the extent of the decline?

Stephen Roach: I think there are a couple of reasons why the Chinese consumption rate is as low as it is. When Deng Xiaoping gave the word to push ahead on reforms and open up the Chinese economy, in the late '70s, the Chinese economy was on the brink of collapse. And so they needed a pretty quick answer, and they needed it to take hold in a relatively short period of time. And so the investment/export model was unleashed, and unleashed with a vengeance. And it did start to deliver immediate results.

The second reason is that as that export/investment-led model began to deliver, the world increasingly embraced globalization, took down trade barriers, and global trade started to skyrocket as a share of world GDP. And so not only was China delivering growth for its own purposes, but it got seduced by the globalization of trade and the ability for this increased share of global trade to reinforce its own opening up.

And so it remained very focused on exports and investment and neglected the heavy lifting that was required to augment that by improved private consumption. And so it never really had a backup plan here. And now that failure to really focus on internal private consumption and the [social] safety net is beginning to be very problematic going forward.

Clay Chandler: What can China do to boost consumption? And what, in your view, is the upper limit of how much China could feasibly raise its consumption rate as a percentage of GDP?

Stephen Roach: I've learned, Clay, in my last 12 to 15 years of following China, don't underestimate the commitment and the determination of the Chinese authorities to address a problem when they finally realize they've got a serious one. I think a realistic goal, and I've given a speech on this in Beijing earlier this year, would be to aim for a 50 percent consumption share of GDP within five years.

I think they can do it. Now that's a big move. That's 14 percentage points of GDP, 15 percentage points of GDP in five years. I think it's achievable if they do move aggressively on social security, pensions, and nationwide medical care.

Clay Chandler: What are the obstacles to boosting consumption in China? And what's your sense of how committed China's leaders are to overcoming that resistance?

Stephen Roach: Well, I think the main obstacles are persuading a large generation of Chinese workers and families who have been displaced under the guise of state-owned enterprise reform—who have lost the sort of cradle-to-grave support, the so-called iron rice bowl, the safety net that had been in place in the prior state-owned enterprise regime—to convince them that it's okay to begin to draw down the excesses of precautionary saving. People say, "Oh, this is a cultural thing in Asia." I don't buy that for a second. I think the excess saving is very much an outgrowth of a necessity rather than a cultural DNA. And it's up to the Chinese authorities to really deliver on the safety net, to dissuade families so that savings motive can change.

Clay Chandler: In an article in the *Financial Times*, you wrote that China's response to the global financial crisis has succeeded in restoring short-term growth but has also raised the risk for long-term problems in the economy. You warned, in fact, that it has raised the possibility of "destabilizing consequences." Could you explain that?

Stephen Roach: Things were pretty bad in late 2008 and 2009—much worse inside of China than the official year-over-year GDP comparisons might have alluded to. If you recalculate the GDP on a sequential quarter-to-quarter basis, the way we do it in the West, the growth rate had slowed pretty close to zero late last year.

There were massive layoffs in export-dependent Guangdong province; the government admitted at least 20 million migrant workers had lost their jobs. So once again, China needed growth and they needed it now. And so what they ended up doing was, first they enacted a massive 4 trillion renminbi stimulus, 72 percent of which was infrastructure. And then they opened up the spigots of bank lending. And they created the biggest six-month lending binge on record: about 7 trillion renminbi in the January-through-June period.

So what I wrote about in the *FT* was that it seemed to me that because the growth imperatives were so urgent, the authorities just opted to get as much growth out the door in as short a period of time as they possibly could. And they ended up stimulating perhaps the most unbalanced sector in the Chinese economy: fixed asset investment, which at the end of last year was 40 percent of the GDP. Now it's probably more than 45 percent of the GDP. We've never seen numbers like that for any major economy in the modern post-World War II era.

Clay Chandler: Is it realistic to think about China as a new engine of global growth?

Stephen Roach: I think China has the potential to become a major engine of global growth. But I think it's unrealistic to expect China to step into that role immediately in this post-crisis era. I think it'll take three years, more likely five to ten years, for China to really have the type of balance and scale of its economy that can fill the void that's about to be left—or that is now being left—by the demise of what heretofore has been the biggest and most dynamic and powerful consumer in the world: the American consumer.