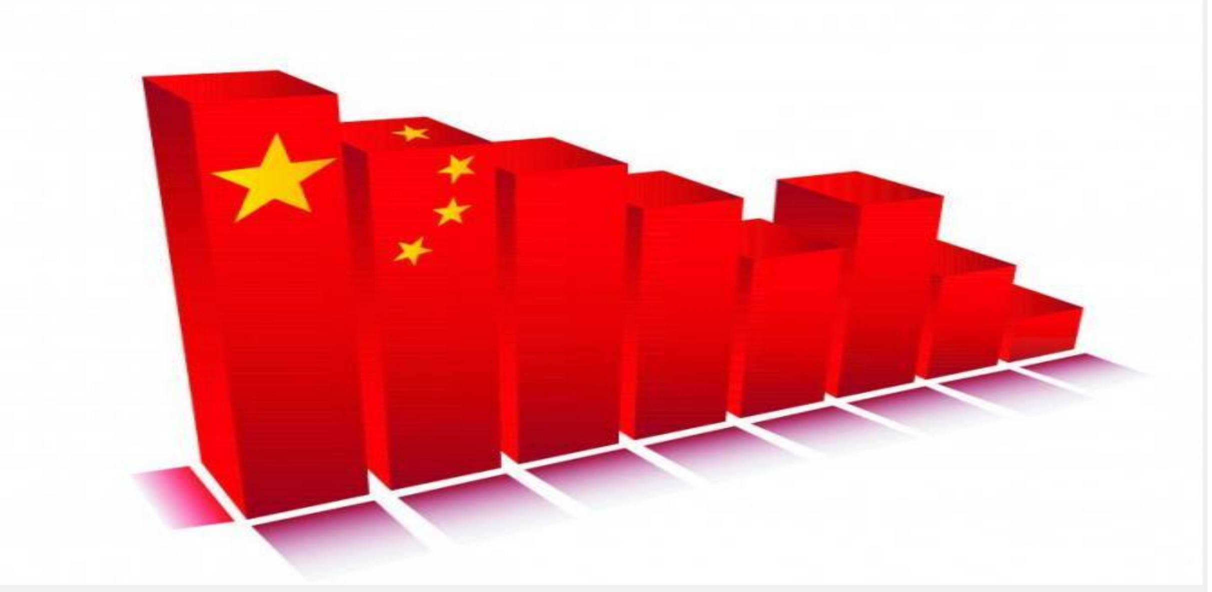
12-2011

Beneath and beyond the Chinese miracle

Singapore Management University

BENEATH AND BEYOND THE CHINESE MIRACLE

Published:
6 Dec 2011



China's rapid economic progress from an impoverished communist state to the world's second largest economy within just three decades has enthralled many economists. That the country shifted from the classical centrally-planned command economy to one espousing free market practices while maintaining communist rule, has all given rise to this question: What exactly is the China model? Is it the hybrid of innovative state ownership and tight political control? Or is the rapid growth the result of liberal economic and political reforms?

From the perspective of Huang Yasheng, there is yet a definitive conclusion to this question. However, there are more pressing urgencies that China's leadership should address rather than defining what exactly is the country's growth model. The double-digit annual growth rates that many people have taken for granted is masking the fact the personal income has fallen behind.

Huang, professor of political economy and international management at Massachusetts Institute of Technology's Sloan School of Management, was speaking at Singapore Management University as 2011's Ho Bee Professor in Chinese Economy and Business. Beijing-born Huang, who earned his doctorate in government from Harvard University, has also previously taught at University of Michigan and his alma mater, Harvard.

"China's GDP has been growing for the past three decades, and there is no evidence this is changing. But there is a need to go beyond GDP, and GDP here in China, has its own issues," said Huang.

He feels that at this point in time, GDP should not just be growing via increase in investments and exports; rather, GDP growth should be driven more by growth in take home pay and the subsequent increase in consumption. "It is important to separate GDP and personal income. China succeeded in exporting itself out of previous difficulties – now, I'm not so sure. There is a need to rebalance China's economy," he said.

State enterprises versus Private enterprises

Besides the tweaks needed between export-led and domestic consumption, China should also try to give its private sector companies a leg-up as it is more effective to do so compared to the state-owned enterprises (SOEs). For historical reasons under the command economic system, China's economy has been largely dominated by the SOEs, which are the bedrock of society as generations of Chinese have grown to rely on the SOEs to provide life-long employment and cradle to grave care.

As China liberalises its economy, SOEs still hog a greater proportion of attention and resources at the expense of privately-held enterprises. For example, when the recent global financial crisis was happening, the government introduced a stimulus programme where 80 per cent of the bank loans made went to SOEs, which employ only 20 per cent of the working population. The private companies – with 80 per cent of the working population on their payrolls – received the leftover 20 per cent of the loans.

To Huang, this policy is a waste of resources. "By supporting SOEs that don't create value – that doesn't create wealth. There is absolutely nothing more efficient in creating employment than by supporting private enterprises. Many large SOEs are profitable only because they were given subsidised financial resources," said Huang. If SOEs were to take into account the costs of capital at the same rates as private companies, up to 90 per cent of the SOE profits would have been wiped out, he added.

Wenzhou and India

Huang is of the view that growth is best led by the private sector. The shiniest example of how private sector entrepreneurial zeal, in a climate of reform and liberalisation have led to economic success, can be found in the eastern province of Zhejiang, and specifically, the city Wenzhou.

Wenzhou was in the news recently, as the credit crunch caused some local businessmen to flee from their debtors, causing worries that this would mark the start of a wider problem. However, from a longer term perspective, there is no denying that Wenzhou, and the province of Zhejiang, has been leading in terms of economic and income growth.

Back in the 1970s, the per capita GDP of Zhejiang was squarely in the middle among the country's provinces. Today, it is the richest province, outranked only by the Beijing, Tianjin and Shanghai. These three cities, under China's political system, are accorded the same status as provinces and do not fall under the control of the provinces they are physically located within.

There are enough big names that began life in Zhejiang to back this claim: e-commerce website alibaba.com, beverage giant Wahaha, as well as Wanxiang, a conglomerate with interests in automotive parts, agriculture, real estate and infrastructural development. "Zhejiang overtook other provinces purely through capitalism, classic market principles," said Huang. After having built their businesses domestically, many of the Wenzhou companies have been on acquisition sprees for foreign assets, he added.

China can also take a leaf out of India: its neighbouring and fellow Asian giant. While India's economic track record thus far cannot be said to be impeccable, there are certain areas where India does better than China: developing their private sector.

Citing a 2009 study done by the Boston Consulting Group, Huang said that out of the top 100 so-called "Global Challengers", there were 38 companies from China and 19 Indian companies that made it to this list. While India trailed in absolute numbers, most of those that made the cut were private companies, while for China, state-owned enterprises figured prominently.

During the recent global financial crisis, India, unlike China, did not bother with huge stimulus programmes to jumpstart its economy. Domestic consumption remained resilient, which kept India's economy going. With or without the crisis, India's relatively stronger domestic demand also means it has a smaller reliance on exports to drive growth – unlike China. "People say that China is growing faster than India, but India is investing at only 50 per cent of what China is investing, and they are getting 70 per cent of China's growth. I think India has gotten this right," said Huang.

China's countryside miracle

Those with shorter memories might think China's rapid developments and big changes only happened after the country's ascension into the World Trade Organization in 2001; alleviating millions from poverty and elevating China's economic status in the world – what many people have referred to as a "Chinese miracle".

Huang believes that this so-called "Chinese miracle" happened earlier, during the 1980s, not long after Deng Xiaoping got both its political economy right and economic reforms going. Interestingly, most of the action happened in the rural areas, and lots of entrepreneurial activities took place away from the urban areas, including the creation of some of the largest private Chinese companies.

“The miracle started in the countryside,” he said.

Kelon Group, a leading white goods maker, began at Shunde country of Guangdong province; Chery, a leading auto-maker that now owns Volvo, began in Anhui province – a region known better for its agriculture and poverty; and agricultural-based conglomerate Hope Group, founded by four brothers in Sichuan who gave up their urban homes for a quail egg farm.

However, back in the 1980s, the country was just recovering from the damaging decade-long Cultural Revolution that ended in 1976. How was the climate of change and reform – especially in the political sphere – interpreted and received?

According to Huang, it wasn’t all that difficult. With Deng at the top from 1978 on, the change was obvious for all to see. “Deng Xiaoping was purged three times, and reinstated three times – this is a well-known fact. His appointment signalled that things have changed, and that he is different from Mao Zedong. Even if you are a farmer in Anhui, you also know that politics have changed,” he said.

The change and liberalisation was manifesting in various ways that will surprise China observers today unschooled in what happened then. For example, back in 1979, the National People’s Congress – typically dismissed as a rubber-stamp equivalent of China’s parliament – held hearings where ministers were subject to questionings from the delegates.

China’s media then was busy exposing corruption – and their targets were not merely on small fry village or county party secretaries, but big fishes up to the ministerial level. There was also open debate in the media on the pros and cons of policies, and elections were held at villages to decide on representation. Even the Communist Party was recruiting capitalists as members, although they were known by the euphemism, “individual labourers”, said Huang.

Furthermore, people were enjoying ownership and control of lots of assets – a reversal of the post-1949 nationalisation. Contrast this with the situation today: local authorities from the biggest cities to the smallest villages have been aggressively acquiring land and homes on the pretext of redevelopment, causing suffering to the rural uneducated, and increasingly, the urban middle class.

More importantly, financial liberalisations also took place in the 1980s. “The reason why it was not well-known was because they occurred in rural, not urban China. This can be explained by ‘observation bias’ – a classical error of many scholars and observers,” said Huang.

For example, Han Lei, then president of the Agricultural Bank of China said in 1984: “We need to allow the existence of *private* free lending and borrowing.” The use of “private” in this instance was especially significant, said Huang, as this word in the context of that era had very negative connotations of capitalism and exploitation. Of course, that this was uttered by a senior bank official made this all the more interesting. “This was not a minor lunatic running around shouting slogans,” said Huang.

Han was not alone. Chen Muhua, then governor of the People’s Bank of China, the central bank, said in 1987 that “the various methods of financial mobilisation have made a true contribution to local economic development” – a statement that Huang views as “incredibly market oriented, progressive view on the part of the regulator”.

Private enterprises founded in the countryside had to share some limelight with companies founded in the cities during the 1980s that have grown to be world-famous today: Beijing-based computer maker Lenovo, and Shenzhen-based telecom equipment maker, Huawei, both of whom have found buyers for their products all over the world.

The Fifth Generation's answer

An entire country's economy cannot merely rely on a handful of prominent companies. China's dominant avenue of growth via exports thus far is, according to Huang, "extremely abnormal". Once you reach a certain size, most of the growth ought to be driven by personal consumption. You are now exporting the surplus and you are subsidising foreign consumers by devaluing your currency," said Huang.

In a sense, foreign consumers are benefiting at the expense of Chinese workers – and increasingly so: income growth is increasingly lagging behind GDP growth. Between 1980 and 2009, China's ratio of personal income to per capita GDP has dropped from around 50 per cent to 34 per cent. This year, this ratio is likely to drop again. "This number is the lowest of any country in any historical period during peacetime," said Huang. By contrast, American consumers have been merrily spending more, with the same ratio in the same period increasing from just over 60 per cent to 70 per cent today.

"Some observers have attributed the relatively low personal consumption to Confucius' value of thrift," said Huang. However, the corresponding ratio for South Korea and Japan is at more than 50 per cent and 60 per cent respectively. "Last I checked, these two countries are also known as countries with Confucius values. Please don't attribute today's economic issues to someone from 2,000 years ago. That doesn't explain the changes in the consumption versus income ratio. It has to be economics and financial policies,"Huang stressed.

So, if China is to avoid the road to further problems, the gap between personal income and GDP per capita must be narrowed. Huang is especially concerned that rural income is lagging further and further behind. Yet, China's economic structure is not doing the rural populace – who still outnumber their urban countrymen – much favour.

"With rural income growth coming down, the opportunity cost of going to Guangdong to seek work is low. This has led to a massive incentive to go to Guangdong to work and as we all know when supply exceeds demand, wages will be compressed," said Huang, referring the southern coastal Chinese province that is a huge manufacturing base for companies like Foxconn (contract manufacturer of the iconic Apple products) and other employers of millions of migrant workers from the inland rural areas.

Just barely two decades ago, per capita GDP and real annual starting wages at Guangdong was RMB 2,500 and RMB 5,000 respectively. Per capita GDP caught up with wages in 1995 at RMB 6,000 each and has since surged ahead. By 2006, per capita GDP, at RMB 27,000, was double real annual starting wages. The following year, it surged 18.5 per cent to RMB 32,000 but wages could only hit RMB 14,000 – barely 4 per cent from the previous year. It only got worse in 2008, when per capita GDP reached RMB 35,000 but real wages, instead of rising, dropped to RMB 12,000.

In effect, a huge production base been created, but at the same time, a huge consumption power sacrificed: overseas consumers are enjoying savings derived from the low wages of Chinese workers.

The big question, inevitably, is this: how can China close this gap? If personal income growth cannot catch up with GDP growth, that will continue to weigh down heavily on personal consumption. This is a big question and it needs an equally big answer. “For the government, to grow GDP, you can invest in airports, high speed railways and other infrastructural assets, it can mobilise all kinds of resources, but, to grow personal income, you require the government to effectively reduce its own power,” said Huang.

He believes that China needs to make changes in areas like pricing of capital, institutional reforms in land policies, as well as political reforms. More accountability and less corruption are in good order too.

Is the country’s political leadership, who presumably also recognises the crux of the issue, ready for the changes? “The current leadership has done much, but these have so far been merely substitutes for reforms; not reforms,” said Huang.

Referring to Vice President Xi Jinping, whose team of so-called Fifth Generation leaders is slated to take over sometime next year, Huang concluded: “Whether or not the next generation of leadership will do that -- I have no idea.”