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Headline: China must look beyond GDP growth
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ASK: NUS ECONOMISTS

China must look beyond GDP growth

By Ivan Png

LAST week, China overtook Japan to become the world's second-largest economy. What next? Is it going to be plain sailing for the Chinese economy from now on?

It is not only China's sustained economic growth since Deng Xiaoping launched economic reforms in 1978 that is remarkable. China's quick recovery from the 2008-2009 global financial crisis has been equally remarkable.

What about China's future? Many economists have been puzzled by an apparent contradiction between China's fast economic growth and the poor state of its legal and political institutions.

Most economists agree that good institutions are essential to sustained economic growth. Yet China systematically receives low rankings for the rule of law, transparency and other such indicators.

As it so happens, this question was discussed in Shanghai last week at the World Congress of the Econometric Society. One of the highlights of the meeting was a panel discussion on the outlook for the Chinese economy. Participants included World Bank chief economist Justin Lin and dean of the Tsinghua School of Economics and Management Qian Yingyi.

Professor Qian explained that, on a per capita basis, China is still relatively poor. He pointed to a strong correlation between per capita income and institutions. In his view, China's institutions are still weak because it is a relatively poor country. His reasoning implied that good institutions are an outcome rather than a determinant of economic growth.

My own research (conducted with my NUS colleague Lu Yi and Hong Kong University economist Tao Zhigang) suggests a more nuanced view. China's economic growth was relatively faster in areas with relatively good institutions. The most prominent of these were the special economic zones (SEZs) established in 1980 – Hainan, Shantou, Shenzhen, Xiamen and Zhuhai – and Pudong, which was added to the list later.

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Deng's genius was to recognise that China's pool of policy-making and managerial talent was limited. So rather than spread the limited pool thinly over the entire country, China would get much better returns by concentrating its resources. This year marks the 30th anniversary of the SEZs. They were as much an experiment in policy as a rational concentration of limited human resources.

What about the future? Economists worry that, in the course of China's recovery from the global financial crisis, economic reform will be stalled – and, in some dimensions, even reversed. This may curtail the country's future economic growth.

One concern is the assumption that the government should increase its ownership of the economy and so control it more effectively. China's four trillion yuan (S$797.6 billion) stimulus included funnelling large funds to state-owned enterprises. State ownership has increased at the expense of private enterprise – as captured by the new Chinese expression, *guo jin min tui* (the state advances and the people retreat).

State-owned enterprises are useful for their quick response to orders from the central government. However, greater state ownership can increase micro-economic distortions. Because they have government financing, state-owned enterprises can more readily engage in inefficient activities. For example, in recent months, state-owned enterprises have been the top bidders in property auctions, fuelling an already overheated real estate market.

Another concern is that the central government has, in recent years, over-focused on gross domestic product (GDP) growth. Chinese government officials whom I recently taught were very clear that GDP growth was their KPI (key performance indicator).

This single-minded focus on economic growth has resulted in large social and economic costs. One is the human toll of 200 million migrant workers living away from home, without access to social services. Another is the obvious degradation of the environment through air and water pollution. Still another cost is the rush to convert land from agricultural to industrial and residential use.

Up till now, the central government's approach has been to use prohibitions and exhortation to ensure that provincial and city governments adhere to national policies. This approach has not worked. For instance, the central government does not allow local governments to borrow. So, taking a leaf from Western banks' books, local governments set up special purpose entities to borrow. As of June, there were more than 8,000 such entities, with total borrowings of 7.7 trillion yuan.

China is now back on the path of rapid economic growth. It is time for the central government to assess the performance of all levels of government with a balanced scorecard, which would account for all important social and economic goals, not just GDP growth. This would be a more effective approach than relying on a panoply of prohibitions with loopholes for local governments to exploit.

President Hu Jintao and Premier Wen Jiabao are nothing if not pragmatic. Hopefully, they will embrace a more nuanced approach to economic development in the next decade. That would be their enduring legacy to socialism with Chinese characteristics.

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A migrant worker takes a break near a construction site in Beijing. China's single-minded focus on economic growth has created a situation in which 200 million migrant workers live without access to social services. PHOTO: ASSOCIATED PRESS

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