China must look beyond GDP growth

By Ivan Pang

Last month, China overtook Japan to become the world’s second-largest economy. What next? It is going to be the great question for the Chinese economy from now on.

It is not only China’s established economic growth since Deng Xiaoping launched economic reform 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 pleasantly surprised and now expect to see a longer-term, better-balanced growth model that will see China catch up with the advanced economies on the basis 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 the quality of its institutions.

As it happens, this question was discussed in Shanghai last week at the World Congress of the Economists Society. One of the highlights of the meeting was a panel discussion on the outlook for the Chinese economy. Participants included World Bank China economic director John Lee and dean of the National University of Singapore’s Lee Kuan Yew School of Economics and Management Qian Yingying.

Professor Qian explained that, on a per capita basis, China is still relatively poor. He painted 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.

It is a question of economic outcome rather than a determinant of economic growth.

My recent research (conducted with my NUS colleague Mr. X and Tsinghua University economist Tan Jingyi) studies a more nuanced view. China’s economic growth was relatively fast in areas where the government or local government had set up special economic zones (SEZs). These included the areas in Shenzhen and Zhuhai, and Urumqi, which was added to the list in 1993.

Deng’s genius was to recognize that China’s pool of policy-making and management talent was far from sufficient to reform or develop the whole country. China would get much better results by concentrating on these areas. This also explains the outcome of the SEZs. They were as much an experiment as policy and the reallocation of limited human resources.

What about the future? Economists worry that, as the source of China’s future growth, the financial crisis economic reforms will stall — and, in some dimensions, even reverse. This may stall China’s future economic growth. The concern is that the government should increase its ownership of the economy and control it more effectively. China’s focus is on state-owned enterprises and large property development companies. The government has increased its influence over state-owned enterprises — as captured by the new Chinese expects, growing fat, as the state advances and the people reheat.

State-owned enterprises are useful for their quasi-fiscal role in order to force the central government. However, growth state-owned enterprises can cause macro-economic distortions. Because they have government financing, state-owned enterprises can more easily engage in inefficient activities. For example, in recent months, state-owned enterprises have been the top bidder in property auctions across the country.

Another concern is that the central government has, in recent years, over-focused on gross domestic product (GDP) growth. Chinese government officials when I recently visited were clear that GDP growth was their top 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, with access to social services. Another is the obvious degraded quality of urban air (and water) pollution. These are not just businesses or regulation issues; they are fundamental social and cultural issues.

Up to now, the central government’s approach has been to use restrictions and education to ensure that provincial and city governments adhere to national policy. For instance, in 2012, the central government set up special penalty entities to borrower. In 2013, the central government does not allow local governments to borrow. The taking of a leaf from Western banks’ books, local government set up special purpose entities to borrow. As a result, there were more than 2,000 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. The Chinese political system, including the Ministry of Finance, should deeply reflect on this question.