

CHINA: PROBLEMS OF GROWTH AND THE GLOBAL ECONOMY

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The news that is not news

It is commonplace that everything to do with China is talked about in superlatives, for example one is constantly reminded that:

- ◆ China's sustained growth is the most extraordinary economic event on historical record
- ◆ It will be the world's largest economy (in PP terms) in about a decade
- ◆ China is the workshop of the world and on its way to becoming the largest exporter
- ◆ Its GDP is already larger than Japan (PPP terms)⁽¹⁾
- ◆ Its GDP is larger than Russia, India and Brazil combined together
- ◆ China is the world's largest recipient of foreign direct investment
- ◆ Its stellar performance is one of the major stabilisers of the world and US economies
- ◆ Its share of global *increases*, during 2000-03, is as follows: World GDP 32%, world imports 33%, world fixed investments 60%, world oil consumption 36%

The normally staid *Economist* seems to have lost its sobriety and proclaims (October 2nd-8th, 2004 – Special Survey on China's Economic Role): "China's ... future prospects remain excellent, built on genuine wealth creation as currently underemployed labour is put to productive use. In contrast American consumers have been living in never-never land, financing their spending by borrowing against illusory gains in wealth⁽²⁾".

China's problems are talked about in equally dramatic hyperbole:

- ◆ Environmental pollution (atmospheric, water and desert formation) on a shocking scale
- ◆ A woeful healthcare system; an utter shame for a country enriching itself so rapidly
- ◆ Rising rural and urban unemployment and underemployment and massive (100 to 200 million) migration to the cities all of which could portend social upheavals
- ◆ Widespread corruption in government and the middle and lower ranks of the Party
- ◆ A growing equity gap – though the GINI coefficient not as bad as many other countries

- ◆ A banking sector in trouble – some estimates put outstanding loans at 140% and non-performing loans at 40% of GDP

Both on the upside and the down side it appears that Napoleon's remark "Let China sleep, for when she awakes she will shake the world" was the understatement of the millennium.

The real news

It is not these quantitative economic indicators, impressive as they are, which tell the real story behind the remarkable events that we are living through. There is, beneath these facts, a more portentous process at work, a process that must make us refocus the very paradigms in terms of which we read the current phase of world history. There are three factors.

- ◆ Demographic: For the first time in history a genuine middle class is emerging in China. Its size will number in the hundreds of millions in the coming decades and whose skill and knowledge will have tremendous significance, not just for China, but for the whole knowledge-based world of the future.
- ◆ Globalisation: The question no longer is what will globalisation do to China, but rather the question of the morrow will be, what will be the characteristics of the globalisation of the future influenced, if not dominated, by the extended reach of the Chinese economy?
- ◆ Society and state: What is the nature of the emerging state in China? The received categories of previous discourse are outdated and inadequate. The post-Soviet era, the extension of capitalism into a new phase in recent decades and the rise of new China as the economic superpower of the 21st Century, must give us theoretical pause.

Discussion

About the middle class

The rest of this paper will simply discuss these three issues briefly. China did not develop a Westernised and modernised middle class during the 19th and 20th Centuries as colonised nations such as India, Sri Lanka, Spanish and Portuguese ruled Latin America, some French territories and the emigrant states of Canada and Australia did. Society remained largely pre-capitalist except for a few pockets, notably Shanghai, and the social classes remained the semi-feudal

relics of the old order – to simplify a little, the nobility and court officials on one side, a huge peasant mass on the other. The great hinterland remained cut-off, eternally unchanging and to use Napoleon's adage, asleep. Revolutionary bestirring appeared, the Manchu's were overthrown in 1911 and Sun Yat Sen's republic was formed, and the momentous Communist revolution began to reshape China from 1949 onwards.

Although the Chinese Communist Revolution was a real social revolution it did not secrete a modern middle class, it merely laid the groundwork. It was China's emergence as a technologically sophisticated, skilled and educated, global economic superpower, that cut loose the threads of high sophistry and rote scholasticism, permitting the old scholarly wealth of that nation to evolve into modern knowledge. This is the process that mediated the rise of the new middle class, already tens of millions strong and perhaps by the middle of this century more numerous than the whole population of Europe or the United States. It will then no longer be a question of American Universities with science and engineering schools populated with Asian PhD students, nor Chinese Americans carrying away Nobel Prizes as they sometimes do now, it will be the coming of age of the biggest pool of cheap intellectual labour in the world. The consequences are profound.

About globalisation

Let us develop the argument about globalisation carefully. The phrase 'China is the workshop of the world' refers to manufacturing industry where Chinese influence, for example in the consumer durables sector is overwhelming. The same *Economist* issue referred to before says that two-thirds of the world's photocopiers, microwave ovens, DVD players and shoes, over half of all digital cameras and two-fifths of personal computers - the last even before Lenovo bought IBM's PC division – are made in China. This list will only grow; refrigerators, TVs, embedded electronics, textiles and apparel, components and machinery are all in the queue.

However, there is something more important. China is not just the premier mass producer of consumer durables, it is also rapidly becoming technologically sophisticated. Optical fibres and photonics, avionics and space technology, drugs, chemicals, biotechnology and nanotechnology are all being pursued vigorously. The state is injecting huge investments in all these directions. Maybe China invests only a fraction of what America does in high-tech research and innovation, but given the wage differential each dollar buys five times more scientists in China! True, in the highest of high-tech area China is still a copier and importer of technology and breakthrough inventions lag far behind the US, but the gap will close. The availability of a large pool of cheap labour actually slows down pursuit of high-tech since China can compete effectively in other ways.

What about China's impact on the global economy? Some of the features of the evolving scenario are already becoming clear.

China's import and export trade has become a major factor in stabilising living standards and economies of other countries, including very significantly the USA. China is not only the world's third largest exporter, well on course for number one place, it is also the world's fastest growing market and, believe it or not, by 2010 China may in absolute dollar terms, overtake the USA in demand growth rate. China's growth is expanding the size of the global market. An economic slow down in China will spread gloom not only among neighbours dependent on exporting to China but also far and wide; Australia, Europe, the USA and Japan. America is sometimes called everybody's consumer market of last resort; China is increasingly playing the role of a complementary engine in respect of industrial production and raw materials demand.

China's growth is boosting economic development in developing countries in strategically subtle ways. As America encircles China strategically from Central Asia and Pakistan through Taiwan and Okinawa, the Chinese counter play seems to be to encircle the US economically. During President Hu's visit to Argentina, Brazil and Cuba agreements were signed for some \$30 billion Chinese investments in industries and infrastructure projects. This undoubtedly is only the start of a process. Discussions have commenced with Venezuela to build an oil and gas pipeline to the Pacific costs bypassing the strategically problematic Panama Canal. The Chinese seem to be cashing in on the leftward political swing sweeping across South America for major economic co-operation and investment.

With its huge current account deficit (\$600 billion by some estimates in 2004) and its currency in decline the US is in no position to go out on an FDI binge. Every dollar it wants to invest elsewhere must be made good by additional inflows into its capital account; that is in addition to the amount required to make good the deficit on the current account. How long and how much more Treasuries is the world prepared to hold in the face of a declining dollar and low interest rates? For how much longer is it in East Asia's interest to finance US profligacy and watch the value of their vast accumulated savings in American bond and equity holdings decline steadily in value? So on the economic front is it going to be set, game and match to China?

Not so easy. Although China has real material growth and real wealth – unlike American asset and housing bubbles – it lacks America's depth of capital markets (though some of this wealth is illusory) and lacks the sophistication of Wall Street in financial markets. Though some argue that much of the wealth criss-crossing the globe in financial transactions is illusory wealth, a mere redistribution of value, it seems to be an illusion that has persisted for a while. This issue, however, is moot to the point being stated here; China's capital export capability is still comparatively small, and it is not savvy with financial market operations and transactions. It has a long way to go before it can challenge American and European wizardry in the world of high finance, FDI exports and investment banking. China will not complete its dominance of the

global market until it extends its knowledge revolution from science and technology to include finance and economics. This will take time. China's FDI outflows are still quite small (\$3 billion in 2003 compared to \$50 billion inflows) and small in comparison with American, European and Japanese FDI outflows, but given China's huge and burgeoning foreign reserves and booming economic performance, outflows are bound to increase substantially.

The question that now arises is, will a process of globalisation co-led by Chinese capital in the coming decades be different in respect of the fundamental exploitation mechanics of globalisation as we know it now? Will it simply be a matter of adding the names of Chinese corporate power-houses to the existing list of Western and Japanese multinationals?

My tentative answer is that there will be significant differences because of the nature of the Chinese state, and consequently, the behavioural characteristics of state controlled economic power-houses (PetroChina, Sinopec, CNOOC, Baosteel, Lonovo, Huawei, Haier, etc). Almost all the big corporations that are going international are, in the final analysis, state owned corporations and this includes listed and partially listed companies. Therefore they carry a political agenda with them in addition to their business interests. Given the geopolitical tensions that now exist this will give rise to significant differences in the impact Chinese investment will have on recipient nations. Although much lamented by liberal economists, and despite the expansion of the private sector in China, when the chips are down the state calls the shots. For this reason, developing countries receiving large Chinese investment inflows are likely perceive a more developmental focus.

Society and the state

This is a vexed question and somewhat outside the more pressing concerns of this Symposium, but it would not be possible to stop without a few comments. None of the old categories

used by yesterday's marxists seems to sit comfortably with Chinese reality; state capitalism, deformed worker's state, bureaucratic state and emerging capitalism all fall short, while socialism and communism overreach. The economy is mainly, and the banking and finance sector almost entirely, state owned or controlled. The foreign owned sector is smaller but dynamic and corners the export and high-tech end of the market. A monopoly of political power resides in the CCP which plays the roles of guaranteeing social stability, mediating a balance of power between the new middle class, the rural population and the urban working class, and driving a stern economic policy.

Society itself is changing with the rise a huge educated and relatively well off middle class which is pampering itself on consumerism. It will be impossible for the Party to continue to enforce strict authoritarianism in the face of the sheer size of the emerging educated classes. It seems to be aware of this and while eschewing Western style democracy there are signs of a slow process of political reform. A new species of animal, a new kind of social formation, is emerging; it would still be theoretical dangerous to make a more specific prediction than to say that neither the term capitalism, nor the old 'deformed workers state' epithet fit.

Notes

(1) Largest 2004 GDP-PPP in \$ trillion: USA 10.3, China 5.7, Japan 3.4, India 2.8, Germany 2.3. The IMF prefers to use PPP in its *World Economic Outlook* since it gives a more realistic comparison of economies.

(2) The same issue of the *Economist* laments: "In recent years many people around the world have found it easier to make money from rising asset prices than from working . . . The surge in share prices in the late 1990s boosted the shareholding of American households by \$7 trillion over four years . . . The value of these shares has fallen but the drop has been more than offset by soaring house prices . . . increased by more than \$5 trillion . . . But much of this new wealth is an illusion". ■

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