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China Grows On?
October 10, 2012, Debate: China Grows On?

Despite an average of 10 percent growth over the last three decades, there are growing concerns about an inevitable slowdown of the Chinese economy. In a debate entitled " China Grows On?" at the 13th World Knowledge Forum, a panel of leading financial and trade experts met to discuss how the Chinese economy, famously dependent on exports to the West, will have to adjust in light of the recent global slowdown.

The panel included Richard Duncan, investment specialist and author of *The Dollar Crisis*; Fraser Howie, MSNBC commentator and author of *Red Capitalism*; Lin Shunjie, Secretary General of the China Chamber of International Commerce; and Xu Dingbo, Associate Dean of the China Europe International Business School (CEIBS).

The discussion began with each speaker offering slightly different assessments of the main sources of China's explosive growth in recent decades. Mr. Howie noted that " China has been going through three very distinct phases, but each phase has ultimately been marked by greater reform, greater opening, and ultimately the embrace of markets." In his view, this reflects the "human instinct of trading and doing business between one another, and providing goods and services."

Mr. Duncan was more direct in attributing China's growth to the explosion in trade with the United States. By contrast, Professor Xu downplayed the role of international trade and credited more domestic factors, such as a huge, hungry, and inexpensive workforce as well as the growth of China's private sector vis-à-vis state-owned enterprises (SOEs).

Likewise, Mr. Lin focused inward, describing a deep-seated and fundamental shift in Chinese attitudes. He argued that before 1978, most Chinese people did not value business or commerce. "Nothing could be commercialized," he said, "but after that, everything changed. They suddenly accepted business." This new orientation coupled with political change quickly led to extreme growth.

On the question of whether Chinese growth could continue, however, the panelists broadly agreed that a slowdown was inevitable. What they saw as the greater question was whether it would be a hard landing or a soft landing.

Mr. Howie noted that both hard and soft landings were already a reality. "We seem to encapsulate 1.3 billion people and the world's second biggest economy in one number: what is the GDP growth rate? As if that single number could encapsulate everything we need to know about China or the Chinese economy," he said.

Mr. Duncan painted a rather bleak picture of an imminent hard landing. He remarked that because 80 percent of Chinese citizens still earn less than ten dollars a day, domestic consumption will be insufficient to make up for the evaporation of international demand. He indicated that without either domestic or foreign consumption, there will be "massive excess capacity across every industry."

The Chinese representatives on the panel, however, were slightly more optimistic. Prof. Xu argued that official accounting figures have a tendency to overstate the severity of China's trade imbalance. Contrary to official figures, which hover around 33 percent of GDP, actual domestic consumption in China is closer to 60 percent, which is "very similar to other countries at this stage of China's growth," he said.

Mr. Lin also argued that a soft landing was possible for China's economy. He stressed, however, that both mindsets and policies must change to enable private enterprises to compete more with SOEs. He maintained that most local governments are hesitant to take chances on the private companies, despite the fact that, for instance, 80 percent of the private members of his Chamber actually make substantial investments in communities. With respect to state-owned companies, by contrast, he noted that "most of them just show up, and most of them sign a memorandum but do not reach an agreement at the end."

Moderator Pan Xiaoli of the ChunQiu Institute alone tried to defend China's SOE-dominated economic model. She noted that this model has protected China over the years from several international shocks.

The panelists, however, were generally both staunch and unanimous in their criticism of this model. Mr. Duncan drew comparisons with Japan, where the bursting of the credit bubble eventually stifled successful SOEs. He warned that it was only a matter of time before China’s export bubble bursts in the same way, putting heavy strain on the robustness of supporting SOEs.

Prof. Xu focused on the general inefficiency of SOEs, contrasting their average return on investment rate of 3.55 percent with the average return on NASDAQ of 7.6 percent. He noted how perverse incentives have pushed leaders to continue making investments in unprofitable factories while ignoring areas with real potential, such as infrastructure investment.

Ultimately, both Chinese experts were optimistic with respect to the possibility of continued Chinese growth. Nonetheless, they both mentioned a number of threats that must be considered, emphasizing above all that the SOE model should cede its place to greater involvement by private enterprise.