Long-Term Challenges Test China's Growth

By ANDREW BATSON

BEIJING -- China's aggressive stimulus has steadied its big economy faster than many expected. But the Chinese government hasn't yet delivered the deep structural changes that are needed to keep growth on track after those funds run out.

China's welcome success in holding up short-term growth could lead it to neglect its long-term challenge, particularly the potential for significant improvements in productivity by further deregulating its hybrid command-market economy. In the cities, hugely profitable businesses are still reserved for state firms, limiting the expansion of the private sector. In the countryside, market overhauls have languished since the 1990s, giving farmers few incentives to invest in their land.

Officials frequently say the financial crisis hasn't changed China's fundamental advantages, such as its large domestic market and competitive work force. That may be true, at least until the aging of its population alters the equation. But the global environment in which China operates has changed. Exports supercharged China's expansion during the past few years, but world-wide trade is shrinking this year for the first time in decades. With U.S. consumers likely to save more for years to come, they no longer will be a bottomless source of demand for Chinese goods.

So China needs an alternative to strong exports if it is to keep growing robustly. "Asia's export-led growth strategy may no longer pay the same dividends as in the past," the International Monetary Fund warned last week.

In the U.S., President Barack Obama has coupled stimulus with a longer-term agenda to overhaul health care, education and energy use. He has been criticized for taking on too much. The most frequent criticism of Chinese President Hu Jintao and Premier Wen Jiabao is that they are doing too little. "The stimulus is a stopgap, not a solution," says Arthur Kroeber, managing director of Dragonomics, a research firm in Beijing.

In China's previous big slowdown, during the Asian financial crisis of 1997-98, the government combined a stimulus with significant overhauls of the economy: It privatized urban housing and renewed the drive to join the World Trade Organization. This time, the government is again spending a lot on infrastructure to support short-term growth -- but so far it hasn't delivered major liberalization.

This year, officials launched subsidy programs to help farmers buy vehicles and appliances, part of an effort to revitalize rural areas, where growth and incomes have lagged behind those of cities. Such temporary supports are no substitute for removing the barriers to rural residents bettering their own lot, like giving them better access to finance. Rural enterprises account for more than a quarter of China's economy but receive only about 5% of bank loans, according to the Organization for Economic Cooperation and Development, a multinational research outfit based in Paris.
Following through on recent government promises to protect farmers' rights to their land -- by giving them written titles and stopping local officials from seizing property -- would encourage farmers to invest in longer-term improvements. Still, agriculture is a small part of China's economy -- it made up 11% of last year's gross domestic product -- and it tends to be a relatively slow-growing sector in other countries.

So the biggest potential for boosting China's future growth and productivity lies outside of agriculture, probably in services. The manufacturing boom of recent years has been aided by policies that allow the largely free entry of foreign investment and fierce competition among domestic firms.

Yet state-owned enterprises still dominate key service sectors such as transport and communications. Removing the barriers to private businesses entering those fields, many economists argue, would raise the efficiency of the whole economy and encourage a new wave of investments in profitable sectors.

"We can't leave this piece of fatty meat for the state sector to feast on. We need to open the door to private investment," says Zhang Xiaoqing, an economist at the Chinese Academy of Social Sciences, a government think tank. He and others draw a parallel to the housing overhaul of 1998: turning housing from a government benefit into market commodity led to a new wave of both corporate investment and consumer spending. Some elements within the government are pressing for that kind of change now.

While stabilizing economic growth is crucial, the People's Bank of China said in its quarterly report last week, "it is even more important to speed up the pace of economic restructuring, innovation and reform."
But that could conflict with another priority for China's government: building up national champions. While state enterprises have piled up record earnings in recent years, officials have been reluctant to harvest their profits or introduce more competition. Says Zhang Shuguang, an economist at the Unirule Institute, one of China's few independent think tanks: "The problem is that the government directly or indirectly controls too many resources. Its own interests are at stake."

Questions:

1. What has been the dominant drive of China’s economic growth for the past 20 years?
2. How will its aging population affect China’s competitive position in the world?
3. What has Chinese government done to improve the agricultural economy?
4. How would privatization of state-owned enterprises affect the productivity in China?
5. What challenges does China face in its long term economic growth?