

China Forum

University of Nevada, Reno
College of Education, COE 2030
Thursday, September 5, 7 p.m.

Please join four UNR China faculty for a single evening forum, to discuss current issues in China, ranging from US-China relations and economics, to human rights and Taiwan. After brief presentations by Professors Maria Chang, Elliott Parker, Hugh Shapiro, and Wang Xiaodong, the floor will be opened for questions. The event is free of charge and is sponsored by the History Department.

CURRENT ECONOMIC ISSUES IN THE PRC

Elliott Parker, Ph.D.

1. Accession to the WTO

China was an original signatory to the GATT, back before 1949, and after many years of trying China was recently admitted into the WTO, GATT's successor organization. WTO commits China to open its markets to foreign trade and investment and to follow consistent and relatively transparent rules in trade, in return for similar access to foreign markets. It is important to note that China conceded much more in its WTO negotiations than other countries conceded to China. The U.S., China's largest export market, already largely allowed China so-called MFN access under GATT and the Jackson-Vanik Amendment, but this called for an agonizing and embarrassing annual congressional review of China's human rights record. Some observers of Chinese politics argue that while some leaders pushed for WTO accession for reasons of national status, Chinese reformers also pushed for it as a way to force change on institutions that were very resistant to it. But accession to the WTO also threatens China's economy in several ways, as I will discuss below.

2. The Rural Economy

By the late 1800's, China had already achieved close to the maximum output of agriculture per hectare of land possible with a pre-modern, labor-intensive technology. While the communists did introduce more new fertilizers and hybrid seeds, until 1978 labor productivity stagnated under the system of communal production and most Chinese ate very poorly. Once the household responsibility system and the creation of rural markets improved incentives, labor productivity jumped dramatically. While more food, and greater varieties of it, was now available, this system also led to the release of millions of workers who moved to the cities or into rural industry.

But – even though farmers made up 70% of the workforce in 1978 and less than 50% in 2000 – there are still almost 20% more farmers in 2000 than in 1978 due to population growth. This means that there is less than 4 hectares (10 acres) per farmer, and about 1.5 hectares per rural resident. This is much too small a scale for the advanced agricultural methods we use in the United States. By the late 1980s and early 1990s, increases in agricultural productivity again slowed down. Many observers are worried. What will happen to farmers once cheaper foods from the United States and elsewhere are made available?

To add to this, China recognizes a growing inequality in incomes, and this is primarily caused by the growing inequality between rural and urban incomes. In the historical development of the United States, rural incomes were at least close to urban incomes. In China in 2000, rural incomes were about 1/3 of urban incomes.

3. State-owned Enterprises

Most Chinese growth has come from new rural enterprises, private enterprises, and a handful of relatively successful state-owned enterprises. Most state enterprises, however, have lost ground. Industrial output from State-owned enterprises fell from 80% of the total in 1978 to less than 25% in 2000. While state-owned manufacturing firms have also seen their share of the urban labor force fall, they continue to receive the lion's share of investment funds. Traditional state-owned firms continue to employ 81 million people, most of whom are in goods and services producing sectors outside of what we normally consider to be the role of government, e.g. law-enforcement, administration, education, et cetera. Many others are in sectors largely controlled by the state, e.g. in joint-stock firms where the state owns the majority of the outstanding shares.

These firms have been really hard to reform, for a variety of reasons, and the reformers in the Chinese government would really like to turn all but the largest firms over to the private sector, by laying off workers, shutting down the many money-losing firms, selling their shares of stock, et cetera. But where will these workers go, and how will the communist party justify its own existence if it no longer relies on the cornerstone of state ownership?

4. A potential banking crisis

Under the pre-reform system, the state-owned banking sector existed to manage firm deposits to ensure that their sales and purchases were consistent with the plan, and channel household savings to the state's investment needs. With reform came a push to force the state-owned firms to borrow from the state-owned banks, rather than depend on grants from the state, to finance their investment projects. However, much of this borrowing was either wasted on consumption or went towards investment projects that never paid off. While the state has begun to push the big four state-owned commercial banks to clean up their bad debt problems and be responsible for their lending, the state also continues to give power over the banks to local governments who want the banks to keep bailing out their failing state firms. By the late 1990s, it was conservatively estimated that 25% of all loans were uncollectible, and while efforts have been made to reduce this fraction there are estimates that this fraction vastly underestimates the true size of the problem. Meanwhile, interest rates are still regulated, and 90% of depositors say they are dissatisfied with their banks.

Once foreign banks are allowed to take deposits from Chinese citizens in Chinese currency, and can lend to whatever projects they wish at whatever interest rate the market will bear, what will prevent depositors from fleeing Chinese banks en masse? And once they ask for their money back, how can the banks possibly comply without going to the state to bail them out? And given the fact that the bad debt problem far exceeds the entire annual budget of the state, how can the state bail out the banks without a massive inflationary printing of new money? As you might expect, the Chinese are currently dragging their feet on drawing up new regulations for the entry of foreign financial firms.

5. Growth

China's growth since reform began has been astounding. According to official figures, China's GDP grew by almost 9.5% per year from 1978-2000, more than 8% per capita. Recent articles in the *China Economic Review* argued that these numbers – especially in the late 1990s – have been overestimates that reflected the government's wishes rather than actual reality, but even so Chinese growth has been astounding and China's transformation, at least in the urban and coastal areas – has been unprecedented.

China is currently growing at a rate of 7-8% per year (though again this may be an overestimate), and many observers believe that this rate is necessary to provide employment for those losing their state-owned jobs and to continue to provide public support for the communist party leadership. Though this has largely been fueled by exports and the growth of the non-state sector, since the Asian financial crisis of 1997 the Chinese government has increasingly relied on fiscal policy – government spending, particularly on big investment projects – to provide the economic stimulus to keep growth up. By 2000 the government deficit was an unprecedented 250 billion yuan (about \$30 billion), only 2% of GDP but over 15% of total government expenditures. Private investment, meanwhile, has slowed, and China's stock markets are not doing well.

Can China maintain this growth rate? Some observers think not, that Chinese growth was caused by a one-time transformation from low productivity activities to higher productivity activities. The potential for a banking crisis, a rural or urban employment crisis, or an inability of government to finance their deficit except through new money could turn this growth around. Others see the WTO agreement as forcing China to continue the rapid transformation of their economy, which lead to more and more growth as the Chinese economy begins to achieve its potential. We shall see in time.