Whither Chinese Characteristics of Market Economy Horizon of China's Fight Back against Scary Recession

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Introduction

The People's Republic of China (PRC) is beset with recession.1 It defies all public pronouncement of the Chinese leadership. Barely a fortnight after Hu Jintao, the Chinese President, Wen Jiabao, the Chinese Prime Minister and Yang Jiechi, the Chinese Foreign Minister had demonstrated and displayed China's rock bed to withstand surging global financial crisis and its cascading aftermath in the presence of 45 heads of states/governments at the 7th Asia Europe Meeting (ASEM) in Beijing, the Chinese State Council announced a stimulus package of 4 trillion Yuan (US $ 585.5 billion) to ward off the wolf of recession as the USA Congress had done in announcing US $ 700 million bail out. Fifteen European Union (EU) member countries and several other important actors in the world economic scene have followed suit in their own ways, as their economies continued to shrink through the third quarter without likelihood of a check during the fourth quarter.

Phenomenon of recession is not something new for the world. It is concomitant to business/trade cycles in a capitalist system.2 Due to forces of globalisation and inter-dependence of the world economies, the recessionary pressure of one country and/ or group of countries tend to breed recession in another country and/ or group of countries. The bust as such can seldom be avoided unless boom is done away with. The capitalist system does not have to be apologetic as it is reminiscent in its objective laws. There is issue just with the socialist system, which got into being as an anti-thesis to this.3 It is still much more in the case of the PRC, which swears by socialism while lives on long despised capitalist road. The appendage "socialist" to "market economy" in specific context of "socialism with Chinese characteristics" serves little intent and purpose except being a cloak.

In this paper, there is an attempt to bring out how best and to what extent the Chinese stimulus package could at long last pull out the Chinese economy from the quagmire of recession much less stop further slide into depression. In its perspective, the paper would shed light on the fact whether the Chinese strides in economic development had reached a stage whereby it was capable of decoupling from the push and pull factors of the global economy. The framework of the study, accordingly, examines: the Spell and Severity; Convulsion and its Inter Sector Spread; the Stimulus Package and its Outreach; and, in finality, the Outlook of Fight Back. The discussions, in the bargain, will throw light on the relative weight of the Chinese economy to square over the losses to consumer confidence. The study will rely basically on open source information to testify various constructs of the study.

Spell and Severity

In the first three quarters of the year 2008, the growth rate of China's gross domestic product (GDP) has been lower by 2.3 percentage point over the same period last year. In absolute terms, it stood at 20.163 trillion Yuan (US $ 2.96 trillion). It included 2.18 trillion Yuan generated by the primary industry, 10.11 trillion Yuan by the secondary industry, and 07.87 trillion by the tertiary industry. While the primary sector clocked 0.2 higher percentage points, the secondary and tertiary industries were down by 3.0 and 2.4 percentage points respectively. While acknowledging the phenomenon of deceleration in the Chinese economy, the Chief Economist of the Chinese National Bureau of Statistics (NBS) Yao Jingyuan struck a justificatory note in response to media a query. He said the growth rate for the January-September 2008 period was higher than the average rate of growth in the past three decades.4 Notwithstanding, the prospect for China's GDP growth during the fourth quarter is still more bleak. While the estimates widely vary, the best fit range between 5.5 to 7 per cent. In the first quarter, the growth rate was 10.6 per cent. It declined to 10.1 per cent and 9 per cent in the second and third quarter of the year 2008 respectively.5 In fact, after peaking to 11.5 per cent in the first half of 2007, the largest ever since 1994, it has been continuously decelerating. Li Xiaochao, the spokesman of the Chinese NBS, squarely attributed the phenomenon to the global financial crisis and weaker demand for Chinese exports.6

There is visible sign of onset of decline in the inflow of foreign direct investment (FDI).The peak of US $ 9.6 billon in June 2008 has since witnessed month after month slide. For the reasons best known to China, there is yet no official data on FDI inflow for October 2008. In its latest report on 19 November 2008, the official website of the Chinese Ministry of Commerce has cryptically acknowledged "a slower clip" in FDI inflow.7 Non-Chinese sources put the amount at US $ 6.7 billion.8 It accounts for 30.2 per cent decline. It is again literally without signs of corrections month after month.9

Interestingly, the simmers started appearing much before the crisis surfaced either in the USA or it got to spread elsewhere amidst hyperbolic assessments of some of the top agencies.10 FDI from the EU to the PRC, excluding Hong Kong Special Administrative Region (HKSAR) had dropped sharply from six billion euros (US $ 9.3 billion) in 2006 to 1.8 billion euros in 2007.11 The same holds good in the case of FDI inflow from the USA.

There is a saving grace that the direction of FDI inflow to the PRC is not EU and USA dependent. The bulk 87.37 per cent inflow of late stemmed from Hong Kong (44.91 per cent), the British Virgin Islands (17.59 per cent), Singapore (5.07 per cent), Japan (4.36 per cent), South Korea (3.70 per cent), Cayman Islands (3.23 per cent), Samoa (2.95 per cent), Taiwan (1.90 per cent) and Mauritius (1.84 per cent). Deceleration in FDI inflow was yet a point of concern as it constituted over 11.0 per cent of the total FDI inflow to China. Zhu Baoliang, an economist at the National Information Centre, predicted a negative growth next year. It is quite another thing that he has attributed higher base of the yesteryears behind the phenomenon.

The brunt of the deceleration is being borne by all the four sets of foreign invested enterprises (FIEs): the Equity Joint Ventures (EJVs), the Cooperative Joint Ventures (CJVs); the Wholly Owned Foreign Enterprises (WFOEs); and, the Foreign Invested Companies Limited (FCLS). Not until recently, they played vital role. They accounted for more or less 27 per cent of value added production, 21 per cent of national tax revenue, and 58 per cent of foreign trade. With the global financial crisis and global slow down knocking at the door, there is quite discernible fall in the EU and the USA invested enterprises in China. During January-May 2008, for example, the number of newly established FIEs by the 15 EU member countries decreased by 24.85 per cent year on year basis. During the same period, number of newly established USA invested enterprises dropped by 28.13 per cent year on year basis. The Japanese and South Korean invested enterprises did as well go down in more or less the same proportion.

Chinese State Administration for Industry and Commerce recently reported that the total number of FIEs by the third quarter of 2008 stood at 424,600. In 2005, the total number of FIEs stood at 552960. It goes to suggest a straight 23.2 per cent out movement of FIEs. It ignores cumulative accretion due to new approvals in two intervening years. The proportion of FIEs in manufacturing and tertiary industries stands at 51.3:48.7. The axe of deceleration in FDI inflow could be roughly estimated to fall in more or less same range.

In the first six months of 2008, the slowdown in exports led to closure of at least 67,000 factories across China.12 It works out shutdown of 11000 factories per month. The latest estimate shows likelihood of at least 100000 factories by the end 2008.13 These affected factories employ nearly 50 million workers. The Chinese Human Resources and Social Security Minister Yin Weimin candidly admitted the number of jobless reaching 10.2 million in the first
10 months 2008.14 This excludes re-employment of 4.5 laid off workers in alternative vocations. A just concluded survey of 84 cities by the Chinese Human Resources and Social Security Minister shows that the demand for workers in the third quarter of 2008 fell by 5.5 per cent. 120 million migrant workers have since returned to their native villages, which they had left two-three decades ago for better future. Pearl River Delta, the home of Made-In- China brand of toys is since seeped into convulsion. As of 21 October 2008, top 50 companies, Smart Union Group included, had applied for liquidation.

Convulsion and its Inter Sector Spread

Notwithstanding the impacts of global financial crisis and consequent global slow down, the crisis in Chinese economy as such is visibly a result of glitch in the export promotion policy. It took the route of FIEs to promote exports, which, in turn, assembled imported components into consumer goods for exports to select few economies. It again offered preferential tax regime for investing in selected economic zones. In the process, Chinese export industry got tied to prevailing business environment in select foreign countries as much as select domestic economic zones.

While it ascended the status of world’s third largest trading economy behind the USA and the EU, it lost dynamism to switch and swap to safer pastures in short run to them as well. When it basked in the glory of crossing over US $ 1 trillion exports proceeds in 2004, the USA and EU had respectively share of 21 per cent and 18.1 per cent in China’s export drive to the world economies. Hong Kong did as well enjoy place of pride with a share of 17 per cent at long last. The other reckonable destinations were Japan, ASEAN and South Korea with their respective share of 12.4 per cent, 7.2 per cent and 4.7 per cent. The rest of the world held share of just 19.3 per cent. In the bargain, any change in demand for Chinese exports goods in the USA and EU was bound to leave abiding impact on outcome. Nonetheless, the other two major destinations of Chinese exports such as Hong Kong and Japan did not have large enough domestic markets. Being closely integrated with the USA and EU economies, they could hardly escape the spin effect of slow down.

The Chinese policy thrust in the wake of Third Plenum of the 11th Central Committee of the Communist Party of China (CPC) got to promote indiscriminately small and medium enterprises (SMEs) as it had happened earlier when the Chinese policy thrust favoured large scale enterprises. It has since over 42 million SMEs, which accounted for 67.71 per cent of the gross output value of all China’s industrial enterprises.15 Notwithstanding, they hitherto employed over 75 per cent of the Chinese workforce in cities and townships. They were again the ones who contributed 58.72 per cent of total tax revenues paid by all Chinese industrial enterprises. Nonetheless, they are the ones which so far generated 65 per cent of China’s patents, over 75 per cent of its technological innovations and nearly 80 per cent new products. Much of the SMEs owe their origin to “zhua da; fang xiao” (grasp the large; release the small) policy of state owned enterprises of late 1990s. As a result, truly private SMEs, started and run by enterprising individuals constitute less than 15 per cent while the majority belong to collectives of yesteryears, particularly the then town and village enterprises (TVEs).16 In the process, they exemplify the characteristics of “old wine in new bottle”. They are largely modelled to produce export goods on the lines of FIEs. As a result, they are subject to the vagaries of elasticity of demand in foreign markets.

As of 15 October 2008, 1391 out of a total of 3631 toy factories in Dongguan in Pearl River Delta in Guangdong province were shut down. Hong Kong listed Smart Union Group Holdings Ltd, filed for bankruptcy and the Hong Kong High Court has since appointed provisional liquidators to wind it up. The decision of the company followed loss of US $ 26 million in one go for want of sufficient demand. Harbour Ring, another company in Dongguan, has cut output and retrenched 4500 out of total of 8000 workers. There is a long list. The region turns out vast quantities of low-cost consumer goods such as toys, textiles, shoes, garments, home appliances and electronics for Western markets. Foreign investors from Hong Kong, Taiwan, Japan, Europe and the USA had flooded the region to set up factories since the 1980s. They are the ones who are now down and out.

Shenzhen, another major manufacturing city in the Pearl River Delta, has been a witness to an identical scenario. Most manufacturing firms in Baoan and Longgang districts of Shenzhen have been shut. Manufacturers of home appliances and electronics suffered the brunt first and went bankrupt. Weak demand in almost all major export destinations, particularly the USA and the EU, rising labour costs, expensive raw materials and the Yuan's appreciation are major contributors. The pang of the slow down is being increasingly felt in all the nine pillar industries of Guangdong province, namely electronics, household appliances, petrochemicals, textile, food and beverage, building materials, paper making, automobile, and medicines.

Shandong, the second largest economic province in terms of GDP after Guangdong has started faltering in no less severe proportion. It laid off 38000 out of 9.14 million workers as on 23 November 2008.17 In the first 10 months of the year, Qingdao, seaside industrial complex of the province, alone dealt with 7897 cases of labour disputes.18 Going by the deliberations of the meeting of the Chinese Premier Wen Jiabao with top economists and entrepreneurs on 25 November 08, there is mortal fear of the phenomenon of slow down inflicting Chinese economy in quite severe proportion in a wide range of fields, namely petrochemical, telecommunications, auto, steel, nonferrous metal, machinery manufacturing, logistics and real estate.19

Stimulus Package and its Outreach

China has been quite quick to respond to the challenges. It did not hesitate to accept and go by Keynesian prescription in preference to Marxian alternative as well.20 To prop up effective demand and sustain supply, China came to resort to a novel instrument, some what similar in spirit but quite different in form to the American palliative. It was a 4 trillion Yuan (US $ 585.5 billion) economic stimulus package, hailed as China's "New Deal" and characterised to contain elements of composed of what the Chinese tend to call "active fiscal" and "moderately active monetary policy".

There has been conflicting reports for long about the funding plan. What has hitherto emerged out, the Chinese Central Government was contemplating to float 1 trillion Yuan (US $146 billion) worth of new construction treasury bonds, with 500 billion Yuan (US $73 billion) scheduled to be sold in each of the next two years. This could bring the budget deficit up to 2.5 per cent of gross domestic product in 2009 and 2010. Responsibility for the remaining 3 trillion Yuan (US $438 billion) of the total package will fall to the provinces, mainly through their own budgets and cheap (subsidised) loans provided by the nation's major banks.21 So far, the People's Bank of China has asked the national banks to contribute a tiny 100 billion Yuan (US $14.6 billion) in loans for infrastructure projects, but this is likely only an initial push. If the State Council approves the provinces' right to issue their own bonds, then this too could provide funding, though it will take time for this mechanism to be operable and for provinces to find markets for their bonds.

The plan initially envisaged 10 major steps: building affordable and low rent houses; improvement of roads and power grids in the countryside; expansion of transport networks, particularly dedicated passenger rail links and coal routes; beefing grass root medical system; construction of sewage and garbage treatment facilities as part of environment protection programme; development of high-tech and service industry; speeding up construction works in disaster hit areas, particularly May 12 earthquake locations; raising average per capita incomes in rural and urban areas through an array of concessions and subsidies; reforms in value added tax rules capable of reducing corporate tax burdens; and, last but not the least, enhancing financial support to maintain the growth rate.

Local governments are also implementing their own measures and investment plans totalling at least 10 trillion Yuan (US $ 1.4 trillion) have been announced.22 It includes 3 trillion Yuan (US $ 439 billion) investment plan of Yunnan and 2.3 trillion Yuan (US $ 337 billion) plan of Guangdong province.

Outlook of Fight Back

At the face of it, the Chinese stimulus package evokes awe. Little difference could have been expected otherwise from a resurgent China, suddenly faced with the home truth of an all round decline in fortune.

The Chinese module yet suffers limitation of untold proportion. The challenges before the Chinese leadership are manifold. It has to ignite and sustain first, declining consumer confidence. Figures released by China's National Bureau of Statistics on 01 November 2008 showed that China's Consumer Confidence Index (CCI) was 3.2 point lower than the corresponding period last year. It had fallen 0.3 point in the third quarter of 2008 as against the second quarter. The CCI, which measures consumers' opinions on employment, the economy, regular income, the stock market and quality of life, was released after the disclosure of a lower entrepreneurial confidence index and a lower business climate index, both year-on-year figures for the third quarter. The NBS data showed that China's entrepreneurial confidence index dropped to 123.8 in the third quarter, 11 points lower than the previous quarter and 19.2 points lower from the same period last year. In the similar vein, China's Purchasing Managers Index (MPI), a tell tale measure of manufacturer's confidence, registered 45.2 in October 2008 as against 47.7 in September 2008. It was again lowest level since the survey began in 2004. No amount of rhetoric could perhaps change the ground situation.

There is again some scepticism about how much of the spending is actually new. This is true both about the stimulus package of the Central and local governments. Notwithstanding, the time lag in the case of central investment plan is two years and the provincial five years. It can not thus bear fruit in the short run. Moreover, all the laid off factory workers cannot be adjusted in one or the other 10 set of work areas identified in stimulus package. This, however, does not undermine their importance in providing some sort of succour to the lives of a large number of skilled and semi skilled workers hitherto rendered unemployed.

To a great measure, China's experimentation in the fightback against the economic slow down shall be a matter of great interest both for the academics and the decision makers. Skewed industrial structure, particularly oriented to produce export goods of relatively high elasticity of demand is bound to suffer the China syndrome.

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