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Dec. 23--BEIJING -- China's per-capita income, at US\$3,800, has surpassed the threshold for a middle-income country.

But even as economists and strategists busily extrapolate its future growth path to predict when it will catch up to the United States, the mood in China became somber and subdued in 2010. Indeed, Premier Wen Jiabao sees China's growth as "unstable, unbalanced, uncoordinated and ultimately unsustainable".

Economic growth, of course, has never been linear in any country.

Throughout history, there are countless examples of middle-income countries becoming stuck in that category for decades or eventually falling back to low-income status. The Nobel laureate economist Michael Spence has pointed out that after WWII, only a handful of countries were able to grow to a fully industrialized level of development.

China's progress over the past three decades is a successful variation on the East Asian growth model that stems from the initial conditions created by a planned socialist economy. That growth pattern has now almost exhausted its potential. So China has reached a crucial juncture: without painful structural adjustments, the momentum of its economic growth could suddenly be lost.

China's rapid growth has been achieved at an extremely high cost. Only future generations will know the true price. The country's investment rate now stands at more than 50 per cent -- a clear reflection of China's low capital efficiency.

There are two worrying aspects of this high rate. First, local governments influence a large proportion of investment decisions. Second, investment in real estate development accounts for nearly a quarter of the total. Some local governments are literally digging holes and then filling them in to ratchet up the GDP.

Consequently, there are simply too many luxurious condominiums, magnificent government office buildings and soaring skyscrapers. Hotels in China's provincial cities make five-star establishments in Western capitals looked shabby.

China has become one of the world's most polluted countries. Dust and smog choke its cities. All of the country's major rivers are contaminated. Although progress has been made, deforestation and desertification remain rampant.

Drought, floods and landslides have become commonplace. Relentless extraction is quickly depleting China's resource deposits.

With China's trade-to-GDP ratio and exports-to-GDP ratio already respectively exceeding 60 per cent and 30 per cent, the economy cannot continue to depend on external demand to sustain growth.

Unfortunately, with a large export sector that employs scores of millions of workers, this dependence has become structural. That means reducing China's trade dependency and trade surplus is much more than a matter of adjusting macroeconomic policy.

After decades of rapid expansion, China has become the workshop of the global economy. The problem is that it is no more than a workshop. A lack of innovation and creation are the economy's Achilles' heel.

For example, in terms of volume, China has become the world's largest car producer, churning out 17 million vehicles this year. But the proportion of models developed by domestic carmakers is negligible.

In an era of rapid technological progress, creativity and innovation, the global economic landscape can change rapidly. Without a strong capacity for innovation and creativity, even a giant has feet of clay. And when a giant falls, many get hurt.

While China's living standards have dramatically risen over the past 30 years, the gap between rich and poor has sharply widened.

Income distribution has remained skewed in favor of the rich for too long, and the government has failed to provide decent public goods. With the contrast between the opulent lifestyles of the rich and the slow improvement of basic living conditions for the poor fomenting social tension, a serious backlash is brewing.

If China fails to tackle its structural problems in time, growth is unlikely to be sustainable. Any structural adjustment is painful. But the longer the delay, the more painful it will be.

China's strong fiscal position today gives it a window of opportunity. But that window will close fast, because beneficiaries of specific reform policies have morphed into vested interests, which are fighting hard to protect what they have.

What the public resents most is the collusion between government officials and businesspeople, described by the respected Chinese economist Wu Jinglian as "capitalism of the rich and powerful".

Breaking this unholy alliance will be the big test for China's leadership in 2011 and beyond. Under China's current institutional arrangements, meritocracy is a prerequisite for good governance.

But meritocracy has been eroded by a political culture of sycophancy and cynicism. So, once again, the dialectics of economic development has brought political reform back to the fore.

China's rise has generated admiration, envy, suspicion and even outright hostility in some corners of the globe. No matter how often Chinese leaders repudiate any hegemonic ambition, wariness about China's intentions will remain.

That is understandable: the rise of new powers has always disrupted the established international order.

When this new power is a nation of 1.3 billion people living under an alien political system and ideology, its rise is bound to cause even more uneasiness.

Fortunately, because of globalization, China's rise is in everyone's interest, as is the rise of other emerging economies.

China should and will play a more active role as a major global stakeholder in such areas as climate change, global imbalances and reforms of the international monetary system. Needless to say, reciprocity will be necessary.

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