

The Chinese Economy with Dr. Michael Kulma (Part 3)

John Major: Now, if you look at China today, it is a curious thing how quickly we have gone from people worrying about China being backward and declining relative to the other countries of Asia [to] worrying about China perhaps being ready to buy the entire world. Should people worry about China as an economic power?

Michael Kulma: Personally, I don't think they should. I think there are two sides to any of these—and there are probably more than two sides—kinds of questions. I think on the whole, China's growth does more good than it does bad. Are there things that the United States and other countries would like to see happen...along the lines of rule of law and human rights issue, and things like that? [JM: Like intellectual property rights, for example?] Of course, but I think all those things are a process as well. But if you look at the overall impact and the overall positive aspects, China has helped keep inflation in the United States down over the course of the last ten years, more and more so as we move into the current period, let's say, beginning in 1978. China is such an economic power now...the demand for goods by the Chinese is tremendous: the Chinese are large buyers of U.S. goods, U.S. bonds, and U.S. currency. So I think the overall good of the Chinese economy for the rest of the world outweighs the negative aspects. That doesn't mean we shouldn't continue to talk about these things, but I think overall the Chinese economy plays a more positive role in the overall development of the global economy than a negative role. I will give you just a couple of examples. The thinking on this has shifted...even over the course of the past couple of years: if you went to Asia three or four years ago and talked about China to its Southeast Asian neighbors or its South Asian neighbors, and you had conversations, whether or not it was with people in the business community, people in academia, or people in the governments, there was a huge concern about, "How can we possibly compete with what China is doing?" I think there are still some of those concerns today, but I think the major focus has moved. If you have those same kinds of conversations today with people, you have people who are figuring out ways of cooperating with China. China is not only a place where we should be afraid of them taking our jobs or producing everything that we produce; there are complementarities between the different systems. The phrases I hear more often are: "How can we work together with China to grow all of our economies?" It's not a "they win, I lose" situation; it's an attempt to have a win-win situation. Then if you bring one more example—I don't mean to go far off base but I think this illustrates the point as well: take a look at countries like India. Over the course of the last year or so, India has exploded onto the world scene. So I don't think we should be afraid of either one of those countries; I think there is room within the global economy for all of these countries. I think that the Chinese economy does have a positive role to play, not just for the Chinese people, not just for East Asia, or the Asian community, but it also has a positive role for...the United States and other developed countries.

Major: One thing you mentioned that I would like to pursue a little further is the development of the domestic market in China. That was a dream, of course, of foreigners for many, many years. Back in the early ninetieth century, an English economist was quoted as saying, "If every Chinese would add an inch to his shirttails, the mills of Lancashire would hum forever." Yet there was no Chinese market for most of the twentieth century and the Chinese were too poor to buy much of anything. That has changed. Now if you go to Shanghai or to Ningbo or many places, you see a lot of evidence of real wealth in China. So what about the domestic market in China? How do you evaluate that?

Kulma: Well, as you suggested, it expanded tremendously over the course of time. If you go to these different places—[remember,] in China we still have to talk about the haves and have-nots, ie, the coastal areas and the more inland areas—but if you do go to these coastal areas and even if you go to the bigger cities that are further inland, you see this [expansion], and you feel it. You feel the vibrancy, going to Shanghai or going to Shenzhen; you can almost feel the capitalism and what a capitalist system is all about. It's hard to imagine that this is what most people have perceived to be China. You can see this growth in consumerism over the course of time. I think moving towards a consumer economy, though, is something the Chinese and the Chinese government are hoping to continue to push towards. I

think the majority of the growth over the course of the last 25 years has been export-led growth; most of the goods being produced by China are going outside of the Chinese economy. That doesn't mean that you can't go to China and find Nike shoes and find all the things you want. But—I don't have the numbers in front of me—the majority of the goods being produced are going out. Now I think we're getting into the beginning stages of China as a consumer economy and, as so you suggest, all of these kinds of things are taking place first in the bigger cities. So, in a place like Shanghai, you go to the main districts, the shopping districts, and it's just phenomenal. It's just like Hong Kong or Singapore or walking down Fifth Avenue in New York. It is fantastic to see the kind of changes that we've seen [in China] over the course of time, in that respect.

Major: Now, what challenges do you see ahead for the Chinese to try to maintain this phenomenal rate of growth over the next few years or beyond?

Kulma: I think there are any number of different challenges. Whereas my overall prognosis would be that we will continue to see quite tremendous growth at this 8 or 9% increase in GDP on an annual basis for the foreseeable future, at the same time, there are things many people talk about as things that could be a wrench [in the works]: if these things happen, what would happen to the Chinese economy? Let me just start with the state-owned enterprises and what we talked about earlier. There are many of these state-owned enterprises that are still operating on a scale that produces huge losses for the state. These state-owned enterprises are then being funded by Chinese banks that, for lack of better terminology, are being told to provide loans to these banks. This creates a huge problem on the scale of hundreds of billions of dollars of bad debt on the books of Chinese banks. There's huge potential—as with the savings and loan crisis here in the United States or the Asian financial crisis in 1997 around the region—for this to become a huge issue. What exactly that tipping point will be, is difficult to say. And the Chinese government has made inroads over the course of the past two to three years in trying to address some of these issues, but it still is a major issue. If China continues to grow at the level it has been growing, 8 to 9% per year, as over the course of the last 10 years, which I would suggest it has the capacity to do, and which reports from the World Bank, IMF, and other organizations also suggest—if it continues to grow at that rate, that would be a positive sign. Most studies suggest China needs to grow at about 7%. If China doesn't grow at about 7%, huge issues with unemployment start to come to the fore. It can't produce enough jobs to keep the people who are already employed *and* keep the people coming out of high school and college employed, [too]. That leads to huge concerns about social stability: we've seen major increases over the course of the last few years in demonstrations against the Chinese government on some of these kinds of issues, issues of corruption, and things along those lines... These could lead to huge issues as far as social stability and control by the Party. That, of course, could derail if something goes [seriously] awry—that could derail Chinese economic growth.

Getting to the issue of corruption: corruption is a major concern in China at many levels of government, society, within the business community... Part of this is a result of the lack of rule of law, the need to continue to improve rule of law within China. It is certainly an issue: there have been on the order of tens of thousands of protests, largely small-scale protests, around the country, against corruption and other business-related problems in the economy. This, of course, has major implications if the government is unable to keep these things under control. If they are unable to address the issue of corruption, you run into serious problems with regard to social instability, which, of course, will have an impact on the economy.

Let me also talk about the rural and the urban divide, which I alluded to briefly earlier. The more rapid rate of growth in China over the course of the last 25 years has happened in the urban and mainly in the coastal areas of China. That is not to say that the rural areas of China haven't grown: there were huge increases in economic growth, more in the beginning period of China's opening than now, but certainly there were tremendous strides made even in those areas. But the gap has begun to grow. And so you have the situation, to put it very simply, of the haves and the have-nots.

The [leaders] that came into power a couple of years ago, Hu Jintao and Wen Jiabao, had a great deal of experience as they came up through the ranks of the Communist Party in rural areas and are aware of these problems... There is a great degree of concentration now on trying to further develop the rural areas, [both] in agriculture [and] in trying to increase the capacity for industrial production. In these inland areas, the Chinese government is moving to address these [social] issues. But—and this is another one of those what-ifs—if this situation isn't rectified, since 70 to 75% of the people in China still live in the countryside, these [problems] have the potential to become huge issues, from social security to an aging population, to many other different things that are going on in the Chinese economy, which individually could have an impact on moving forward, but, taken together, of course, could have a huge impact on what will happen to the Chinese economy.

China is also affected by the external environment. A recession in the United States would have the potential huge ramifications for the Chinese economy. The United States is one of the largest importers of Chinese goods in the world. But of course a recession in the United States probably would lead to problems in Western Europe, another of China's largest trading partners. And despite the fact that China is moving towards consumerism, there's still major concentration on export-led growth. So, a recession in the outside world could have huge ramifications for that 8 to 9% growth rate in China, perhaps bringing that down below 7%. You could [also] run into the danger of unemployment, and you still have the problem of corruption issues. You have the potential, I think, for many of these things happening. I'll end by saying that people have been saying these things for very long time. When I was in graduate school and we were taking classes on China's economy, many of these issues arose, and people said it was only a matter of time before this happened, for example, before the banking system collapsed. We just need to very carefully watch these different things and track them very closely: if there are more and more problems in the banking system, if China continues to avoid addressing these things, if rural incomes aren't going up, if China isn't addressing issues of corruption, then these will be indicators that there are more serious problems to come.

Major: Sounds like interesting times ahead.

Kulma: I think that it is a fantastic time to be involved in studying China.

Major: Absolutely! Mike, thank you for being with us.

Kulma: Thank you, John.