China: 2005 and Beyond

A presentation by Andrew Leung

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NPC 2005

- From Growth to People-centred
  - Government 'for' the people

- 5 Balances
  - Urban/Rural
    - 2/3 population still in countryside
    - agric. tax to be phased out by 2006
    - rural income to rise by 5% p.a. (urban income by 6% p.a.)
  - Human/Environmental
    - China's av income = US at 8% growth by 2030 - 40, but projected consumption at US level would by then be 2/3 of world production + more steel than the entire Western world + 99 m bpd of oil compared with current world output of 79 m bpd.
    - Only 7% of world's arable land with scare water resources
  - Economic/Social
  - National/Local
  - Inward/Outward

The economy (1)

- Already 2nd largest (PPP) - > USA in 2 decades
- Basic consumption > US except auto & oil
  - Refrigerators, TVs (+50%), mobile phones (+66%), >2x steel
  - Rapidly expanding consumer market
    - At 8% growth, top 100m household would reach West income levels by 2020
- 3rd largest exporter (7% of world output)
  - Now ahead of Japan
  - Rapid growth in technology-intensive exports
    - Share of global electronics – 9.5% (1992) to 21.8% (1999); ½ Digital Cameras, 2/5 PCs
    - VW & Honda to export China-made cars; growing outsourcing of auto parts to China
  - OEM-ODM-OBM (emergence of MNCs)
    - Lonovo (Legend) - IBM
    - Haier (6% of world refrig, 30,000 outlets in 100 countries)
    - TCL – Thompson (to become world's largest TV manufacturer)
    - Huawei Technologies (telecom)
  - Extremely competitive at both low and higher end
    - 28% of world textile and clothing market
    - Low per unit cost (wage 35-50c/hr or even lower if further inland + economy of scale)
    - High labour productivity and efficiency (unsold goods from 5% (1997) to 0.1% (2004) of GDP)
    - Good supporting logistics & infrastructure, including linkages to global supply chains
- Increasing outward investment
  - US 25b (1999) – 9,000 affiliates in 180 countries
  - e.g. SAIC interest in overseas acquisitions

The economy (2)

- Per capita GDP US5300 ~ 1/7 of US
- People more educated
  - High literacy rate 94% (98% with primary schooling)
  - 160,000 went abroad to study in 2002
  - ~ 40,000 computer science graduates p.a. (25,000 software students trained in India)
  - 300 m internet users (100m > US)
  - 90 international research partnerships in Mainland China (3 x India, > HK+ Taiwan+ Singapore)
  - 2^{nd} only to US in published technical papers on nanotechnology; leading in stem-cell research
  - Still increasing problem of executive recruitment and retention
- Rapid urbanisation
  - Farming population down from 68% (1981) to 45% (2001)
  - 500 m to move to cities within next 17 years
- Non-State sector ~ ¾ GDP
  - 5 more sectors open to private investments (power, petrochemical, telecom, railways, aviation)
- Import – 30% GDP (Japan 8%, US 14%)
- Trade – 70% GDP (US 20%)
- FDI – 45% of GDP (IMF) (~US500b in 2003)
- RMB becoming a hard currency?
  - Increasing outside circulation (though only 30b yuan)
  - Increasing influence on Euro and USD exchange rates through flow of funds
  - Not too far-fetched as a reserve currency if supported by greater long-term stability?
    - Normal life of reserve currency=100 yrs
    - Portugal 1450-1530; Spain 1530-1640; Holland 1640-1720; France 1720-1815; Britain 1815-1920; USA 1920 -?

The economy (3)

- Chinese diaspora
  - >50m with liquid assets ~ 2/3 of Japan’s bank deposits (Economist)
  - Greater China trade ~ 2 x Japan
  - China biggest market for virtually all Asian nations
- Expanding WTO conformity with international norms
  - Average tariff down to 10.5% (2005)
  - Transparency
  - Level-playing field
  - Health and safety standards
  - Environment
  - Workers rights
  - IPR

Domestic Pressure Points

- Imbalanced development
  - NPC 2005
  - Resource limits to rapid growth of a fifth of mankind
- Unemployment/Underemployment
  - Continuous rapid growth needed to generate 9m new jobs p.a.
  - 120-175m transient un- or under-employed population from farms
  - 10 m graduates p.a.
  - 4.5 m laid-off from SOEs p.a.; though so far 90% of 28 m laid-off have found new jobs
- Increasing pension obligations
  - Economic reform, WTO, aging and one-child policy
  - Could run up to 100% of GDP by 2020
- Non-performing SOEs
  - SOEs account for ~ 90% of bank loans
  - Non-performing loans 20-45%
  - WTO compliance – State to stop funding bankrupt SOEs within 4 yrs
- Unabated corruption
  - Non-level playing field, non transparency, and under-developed rule-of-law
  - Exacerbates village hardship
- IPR violations
  - 2/5 foreign enterprises losing 20% revenue
  - Brazen infringements from shoes to software (92% pirated)
  - Ineffective enforcement (fines based only on seizure; export not an offence)

Guanxi & Local Knowledge (1)

- '30% on business; 70% on relationships' (Zhang Hongwei, Founder, Orient Group)
- 'Nomenklatura Capitalism' (Jonathan Story)
- 1/3 Party and State officials have influence over commercial decisions
  - Many ministries and govt agencies own commercial corporations
  - Extensive and interlinked network between State, Province, Prefecture, City, Town, and Village authorities
- Nascent rule-by-law and rule-of-law system
- 'The mountains are high and the Emperor far away'
- Private sector account for only 1% of bank loans but 37% industrial output; 80% new growth; and 90% new jobs.
- Political sensitivities
  - AT&T - post-June 4 pullout led to exclusion from JV until normalisation in 1993-5
  - Avon - 1998 State Council ban of door-to-door sales for fear of grass-root-type organisation
- Risk of cannibalisation by local competition
  - Whirlpool – from 1994 JV to supplying refrigerators under Haier and Kelon
    - now Haier has 15 design centres, 46 plants worldwide, & ¼ US market while Kelon has ¼ of China market

Guanxi & Local Knowledge (2)

- Leveraging local network
  - Carrefour – 2nd largest chain stores in China within 5 years; US$1b turnover, 28 outlets in 15 cities (2000)

    - strong local support bypassing unrewarding Beijing lobbying

    - retrospective Beijing approval
  - KFC – 450 outlets
  - Ericsson – franchising success

- Leveraging national support
  - Holding-company (Kodak) formula for national roll-out, giving local/national partners a stake
  - Over 100 MNCs inc Coca Cola, Siemens, Unilever
  - Kodak – helping China to build photo-finishing hub
  - BASF – petrochemical industry with Sinopec
  - Cisco – national financial network
  - State Street – retirement plans with BOC

- ‘The best partner is the one who shares the same dream, but not the same bed.’ (Not Confucius!)

International Pressure Points (1)

- Oil & Gas
  - ¾ of China's energy consumption is coal (11% of world reserve)
  - Growth in oil demand ~ creating one UK every year
  - 9% (now) and 20% (2010) of global energy
  - 50% (now) to ~ 70% (2020) imported, mainly from the Gulf
  - Outward acquisitions
    - Russia – W-E pipeline to have only an offshoot to N China; Siberian energy costly to explore and transport
    - Kazakhstan, Iraq, Venezuela, Sudan, Canada (oil sands) etc
    - Conflict with Japan and ASEAN countries in East/South China Sea
  - State Council Energy Office on the cards
- RMB
  - US protectionism - China Currency Act (27.5% tariff if no revaluation in 180 days)
  - Defence –
    - China exports have ~ 75% import content; so 20% rev. = 5% export price increase
    - China ~ 10% of US trade; so 20% rev. = 2% impact on US trade
    - China's trade surplus with US largely offset buy trade deficits with rest of Asia
    - No revaluation is likely to alter China's extremely low costs and high efficiency
  - Likely response
    - Controlled outward investments
    - Export Tax
    - Widening band (3 – 5 %) ?
    - Floating (after completing major financial reforms 5 – 10 yrs)?
    - Asian currency?

International Pressure Points (2)

- International Engagements
  - US
    - Post Cold War & Neo-Conservative encirclement?
    - ‘Dancing with the wolf’ – Jiang Zemin
    - Protectionism (loss of manufacturing jobs in S & MW v exports (aircraft etc) & outsourcing)
    - Oil
    - Taiwan
    - Japan
    - N. Korea
    - UN Security Council reform (China’s response – LDC first priority)
    - Human Rights & Democracy
  - EU
    - Pro trade & investment
    - Arms Embargo
    - Human Rights & Democracy
  - Japan
    - ‘History’
    - UN Security Council
    - Territorial/Oil exploration/Fishing rights

International Pressure Points (3)

- India
  - 2005 ‘New Dehli’ accord
  - Task Force on possible ‘Free Trade’ pack (2/5 of mankind)
  - Recent US/India rapport
- Taiwan
  - Anti Secession Law
  - Chen Shui-bian curbed by recent Parliamentary election set-back (people of Taiwan do not wish to go too far)
  - Rapprochement of Lien Chan (KMT) & Soong Chor-yu (PFP)
  - Economy increasingly interwined with Mainland China
  - Status quo serves US best
- Russia
  - Oil
  - Siberian border
- Labour-intensive LDCs
  - Mexico – export down from $121b (1980-99) to $13b (1999 –02)
  - Pakistan, Bangladesh, Sri Lanka etc (cf. Premier Wen’s recent Indian tour)
  - Many of the ‘48 Club of LDC’ export oil, minerals, and agricultural products to China

And Beyond (1)

- Ideology has given way to Performance for Legitimacy
- Stability with Growth
- Authoritarian meritocracy
- Reminiscent of ancient Chinese values
  - Mandate from Heaven - Hearts of the People
  - ‘Oppressive Government is more terrible than the Tiger’
  - Civil Service Examinations open route to ruling class
- No organised nation-wide opposition - improving satisfaction levels
  - Great strides in economic well-being
  - Justified rising national pride
  - Fear of chaos (memories of Cultural Revolution, former USSR collapse)
  - Government sensitivity to grass-root mobilizations e.g. Falungong, Religions

And Beyond (2)

- Progressive Reform
  - Broad leadership consensus of direction
  - Increasing institutionalisation of decision-making
    - Leadership transition
    - Abolition of Bedaihe ‘summer retreat’
    - More expert consultation and analysis, increasingly with foreign input
  - Polibureau and various levels of government becoming younger and more educated
  - Professionalisation of the Civil Service – open recruitment examinations
  - Co-opting new stakeholders to Party and Constitution (16th Party Congress)
    - Private Sector
    - Individual Property Rights
    - Businessmen as a Class
    - ‘The Three Represents’
  - State sector continues to shrink
  - Greater emphasis on Rule by Law and Rule of Law

And Beyond (3)

- Still a Long Way
  - State Development and Reform Commission (SDERC) framework for 11th Five-Year Plan (2006 -10)
    - 1. China-US relations
    - 2. The Taiwan Question
    - 3. Border security
    - 4. Personnel changes
    - 5. Globalisation
    - 6. Foreign Trade
    - 7. Financial risks
    - 8. Agriculture (sector, farmers livelihood, village as socio-economic unit)
    - 9. Income gaps
    - 10. Unemployment
    - 11. Social order
    - 12. Public security
    - 13. Environment
  - Growth in GDP @ at PPP not as spectacular as it may appear
    - China (6.1% p.a. 1978-04)
    - Japan (8.2 % p.a. 1950-73)
    - South Korea (7.6% p.a. 1962-90)
    - Taiwan (7.1% p.a. 1958 -87)
  - > quarter century to catch up with Japan’s GDP per head
    > 3 decades to catch up with S. Korea’s relativity to the US
  - Zhu Rongji’s famous 1.3 billion multiplier

And Beyond (4)

- Learning from others
  - Soviet Model (collapsed)
  - Korean Model (chaebols)
  - Singapore Model (patriarchal leadership, enlightened meritocracy, discipline, extensive foreign investment)

- China's own paths, style and pace
  - 'Black-cat. White-cat'
  - 'Seeking truth from facts'
  - 'Feeling the stones'
  - China is unique – a fifth of mankind, 56 ethnic groups (93% Han)
  - The Second 'Represent'

- Convergence with Global Village Norms
  - WTO obligations
  - International engagements

Thank you

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2005

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