PacNet
Number 71

Pacific Forum CSIS
Honolulu, Hawaii

Nov. 8, 2012

China: The Costs of Hyper Growth by Laurence Brahm

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China's high-growth dependency on fixed-asset investments has brought with it high energy costs, opening a Pandora's box of inflation, raising costs of production, transport costs, and labor wages, while reducing China's competitive advantage and threatening to roll back economic achievements that characterized the China economic miracle. These high costs are driving many foreign manufacturers to pull investment from China to relocate in more efficient labor-intensive countries such as Vietnam, Malaysia, and Indonesia, where wages and corruption are containable.

In many ways, China's fixation on hyper growth led to China's economic miracle, but now it threatens to unravel this achievement. Aside from creating economic distortions and bubbles across the nation's economic landscape, it also has fueled unrealistic expectations among the populace. Twenty years of hyper growth have left a generation with no reference point of recession or depression to fall back on. China's entry into the World Trade Organization (WTO) in 2002 and the massive inpouring of foreign capital since have integrated China into the global community in a way with which it lacked experience.

The notion of keeping growth rates above 8 percent began in 1998, when then-Premier Zhu Rongji issued a policy framework called "the three guarantees": no less than 8 percent growth, no more than 3 percent inflation, and a stable Renminbi currency. Stimulus was used to build roads, ports, townships, but within a rational framework. Goods had to get from factory to port. You needed a port to put it on the ship, etc. But the 10 years under Wen Jiabao amounted to a blind fixation on this high growth rate. China's leadership for the past decade has judged everything based on GDP. As a result, each province invests in redundant infrastructure to meet targets. This has consumed vast resources, forcing price hikes in all sectors. During Zhu's term in office there was focus on controlling inflation, knowing the serious impact that price hikes could have on social stability. The current policy is to focus on growth in the belief it will factor out inflation, which the state does not seem able to control.

A decade of pumped-up growth has led to an uncoordinated rollout of infrastructure. You need a road from township to port, but you don't need 10 roads, each laced with security surveillance cameras. The result was unbalanced growth. Meanwhile, Wen unleashed all restrictions on mining; not surprisingly, coal mining surged during this period. Zhu's policies to reforest vast areas of landscape desecrated during the Great Leap Forward and Cultural Revolution were cancelled. Deforestation returned as indiscriminate mining licenses were issued. China embarked on a global scramble for resources; Chinese mining interests spread from South America to the African continent. For China's leadership, this could sustain growth and, in turn, social stability. Some officials and economists in China, however, fear that this is unsustainable – capitalism on steroids that is in danger of derailing unless older policies of balance are re-adopted.

The social cost of a teetering medical-pension system and popular outrage over environmental destruction and its impact on human physical and mental health represent the call of the Chinese people to rethink this hyper-growth model in favor of something more holistic. Ten years ago the Chinese government estimated there were some 80,000 riots each year, most as a result of local police abuse and corruption. Today, a conservative estimate suggests there are some 150,000 riots a year, a near doubling. The causes are local corruption, police abuse, land grabs, and environmental desecration. Rather than being a source of social stability, the hyper-growth model is at the root of this problem.

Much of the social unrest is triggered by environmental desecration caused by industry supported by local government. New construction means land grabs, facilitated through police abuse and financed by local corruption. Meanwhile, a few people stuff their luxury homes with brand goods and gridlock the nation's traffic with BMWs, Mercedes, and Ferraris while sucking up national water reserves on their golf courses. For the outgoing leadership and their coterie of business interests, these are signs of economic success. People in the street feel differently; indeed, resentment is common.

For those outside the system, the edifice of growth and short-term profit seemed insurmountable. Many on the inside realize China's economy has become very fragile. China is now facing the same problems as it did a decade ago, requiring major reforms in many sectors. But one basic component remains: it still needs massive stimulus to drive the economy.

China must get back to basics with a more balanced macro-control policy as was used to transform China from socialism to a market economy, a system that seeks gradual adjustment rather than sudden shock. Possibly the only way to do this is via a green economy.

A Chinese financial sector official observed, "This is a big challenge – bigger than the reforms of the '80s and '90s because then we did not know what capitalism was; now we know what capitalism is. But each department of government and every sector of the economy guards its own interests. Whether at the central or local level, it is all about controlling and profiting from resources. So this reform will be a much bigger challenge because we are not entering an unknown area, it is about people giving up what is already known."

This cannot be done without re-examining China's social values. People are absorbed by what even the official state media calls "money worship." It has possessed the whole society. International luxury brands are the means of social identity and status recognition. Finding more balance in China's economic growth means more than just using fiscal and administrative levers to control the economy. It means re-defining social success. For China this may be the biggest challenge of all.

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