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CHINA ANALYSIS: 21

CHINA AND THE GLOBAL CRISIS: WILL BEIJING BE PART OF THE SOLUTION?

CONTENT

Strategic culture, power balances and the analysis of geopolitical shifts are a long-standing Chinese obsession. Academic institutions, think-tanks, journals and web-based debate are growing in number and quality. They underpin the breadth and depth of Chinese foreign policies.

China Analysis introduces European audiences to the debates inside China's expert and think-tank world, and helps the European policy community understand how China's leadership thinks about domestic and foreign policy issues. While freedom of expression and information remain restricted in China's media, these published sources and debates are the only available access we have to understand emerging trends within China.

China Analysis mainly draws on Chinese mainland sources, but also monitors content in Chinese-language publications from Hong Kong and Taiwan. Reports from Hong Kong and Taiwan reflect the diversity of Chinese thinking, with occasional news and analysis unpublished in the mainland.

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Introduction
by Francois Godement

Since the beginning of the global crisis, the world has been wondering about China's response. Would there be negative shockwaves from a Chinese economy crippled by its over-reliance on exports? Or would the global economy be rescued by the unleashing of China's domestic demand, with the Chinese spending potential largely intact thanks to huge financial reserves and the budgetary surplus? And would China act to end the global credit crunch by contributing some of its vast financial holdings and providing much-needed capital for international public lending?

On the eve of the G20 meeting to be held in London on April 2, questions regarding the role of China have grown more specific. For example:

How will China react to Europe's financial regulatory proposals, which would directly impact its capital flows relying on offshore centres?

How will China react to the Obama's push for simultaneous global reflation as a first step towards monetization of the huge Federal debt? To be sure, "quantitative easing" by the Fed immediately sends the US dollar downwards, thereby decreasing the value of China's holdings in greenbacks.

With whom will China link itself in the transatlantic debate? Will it side with Europeans who push for heavier re-regulation and for reform of the world financial architecture? Or with Americans whose priority is to find a fix to jumpstart the economy?

This rising tide of questions and expectations regarding China is now colliding with a Great Wall of ambiguity.

First, China is suffering from the global crisis, but not nearly as much as its Asian neighbours. Starting in early 2008, the government has voluntarily punctured China's real estate and stock market bubbles, Its low-cost export model has fared better than that of other Asian producers of high-end or processed goods. Only from February 2009 onwards has China's decline in exports finally matched the decline in imports – and this is only a temporary situation in our view. The steepest decline registers in the area of steel exports – and even in this case, the drop in China amounts to less than the overall global decline in demand for steel. Typically, the international media has trumpeted "the demise of Dongguan shoe manufacturers," but as of February 2009, shoe exports are only down 2.3 % year or year. The reason is clear: the world's need for cheap new shoes from China will always surpass its need for flatscreen televisions from Japan or Korea.

Questions regarding China's stimulus spending package and its real rate of growth are much harder to answer. This issue of China Analysis demonstrates that in spite of an increasing prioritization of health and social spending, most of the stimulus is being spent on concrete and infrastructures – all the more so as local administrations respond enthusiastically to calls for more loans and spending. A rise in so-called consumer spending apparent since early 2009 is actually the result of more spending by administrations and firms. This suggests that the decline in China's domestic economy is probably larger than official statistics reveal. During the course of the past six months, China has subtracted, not added, to global demand; and a switch by China to a new economic model based on consumer and social spending will take at the very least several years to achieve.

It is fair to point out that China too has taken a - little-advertised - financial beating. The value and return of its huge dollar bond holdings are obviously down. Untimely purchases of US shares by CIC and SAFE, China's leading investment arms, have proved disastrous. Worst of all, the Fed's monetization of a ballooning US public debt will be achieved at the direct expense of its international creditors – most notably, China.

To borrow from a new Chinese best-seller penned by two nationalist authors, "China is not happy." Signs of anxiety are evident. China is hoarding future contracts for energy and raw materials – oil, gas and copper. The logic driving this choice is debatable: if energy prices shoot up again, producers will likely continue their notorious practice of re-negotiating long-term price agreements. In advanced countries – and especially in Europe, on whose national divisions China currently thrives – China is shopping for both key technologies and for firms at bargain prices. This makes more sense, but could soon lead to political tensions if the trade surplus continues unabated.

Most probably, China will neither choose sides nor commit itself at the coming G20 summit. Europe's call for transparency and more regulation is likely to fall on deaf ears – President Hu Jintao has announced a personal decision not to meet with President Sarkozy (who happens to be a key promoter of these regulations). On March 23rd, China's central bank governor Zhou Xiaochuan issued an unprecedented call for a global shift away from the dollar to an international reserve currency. This proposition, coming from the world's largest holder of dollar-denominated reserves, is hardly credible. But it provides good cover, and a warning to boot. The reason is obvious. China will inevitably be asked to provide its fair share of new resources to the IMF. China will be reluctant to do so, and Zhou Xiaochuan's proposal allows it to seek political cover by basing its reticence on a principled stand on reform. The implicit warning is that if the dollar keeps declining, China wants to see the yuan fall with it in order to enjoy the benefits of a competitive devaluation. If this failed to happen, China will raise hell with its main debtor, the United States.

1. China's hour? Seeking opportunity in American weakness

by Mathieu Duchâtel

Based on:

Jiang Yong, "The impact of the financial crisis and China's political responses", Shijie jingji yu zhengzhi (World Economics and Politics), no. 340, December 2008, p. 11-14.

Zhu Feng: "The consequences of the financial crisis on international politics", Shijie jingji yu zhengzhi (World Economics and Politics), no. 340, December 2008, p. 15-19.

What impact will the financial crisis have on the international system? Will it accelerate the decline of US power? Will the new Democratic administration in the United States succeed in reversing the trend? Jiang Yong[1] and Zhu Feng[2], two respected members of China's strategic community, perceive the crisis as a chance for China to increase its influence in the world. Their view is based on a classical reading of the emergence and decline of the great powers through history; in outlining their position, they emphasise that the nature of contemporary world politics makes it highly improbable that a sudden transformation of

1 Jiang Yong is Director of the Centre for Economic Security Studies at CICIR.

2 Zhu Feng is a lecturer in international relations at Peking University.

international order could be brought about by war. Implicitly, they raise the key question for grand Chinese strategy: does China have a greater interest in a transformation of the global order or in a stability jointly managed with the United States?

Does China have a greater interest in a transformation of the global order or in a stability jointly managed with the United States?

A weakening of the dominant power in the international system would encourage unrest and local conflict. In this regard, Zhu Feng, predicts a reduction in the capacity of the US to play the role of international policeman. With a budget deficit of 460 billion dollars, and at a time when additional resources will be allocated to economic and social matters, Washington's room to manoeuvre in projecting its military power abroad is diminishing. In Zhu Feng's opinion, these circumstances pose real risks of an escalation of conflicts that have lain dormant to date because of the efficacy of US interventionism.

Jiang Yong's analysis is different; he outlines a scenario whereby the US will preserve its hegemony through a projection of military power. Although he dismisses the possibility that Washington would embark upon a new war in order to provide a solution for its internal problems (转移视线 模糊焦点, *zhuanyi shixian, mohu jiaodian*), the military strength of the US is the sole part of its global power which remains unscathed by the crisis. In addition, the defence budget continues to grow, despite the ballooning of the public deficit. Whilst Jiang Yong predicts stagnation, even a decrease, in US military power in the long term, he also holds the view that a demonstration of military power can be expected in the years ahead, to put an end to the perception of declining US power internationally.

Without a doubt, the economic foundations of the US hegemony are shifting under the effects of the crisis. The depression shows the superiority of the traditional German or Japanese banking model compared to the US commercial banks. The sovereign wealth funds of the emerging countries now have increased space to operate in the world. The international financial rules, drawn up by the US, might be defied by the allies of the US now that its legitimacy is being called into question. The financial economy of the US consumed the country's capital and human resources, resulting in a slowdown of technological innovation and reduced competitiveness. The capacity of the US to recover from its current situation is called into question by this economic security specialist.

The world today is not the world of the 1930s. The possibility that the increasing instability in the international system will degenerate into a world war is dismissed by Zhu Feng, although he proposes an interesting comparison between the current crisis and that of 1929-1933. In this he echoes Alan Greenspan and Lee Kwan-yew, who have assessed the current crisis to be as serious, or more so, than the Great Depression.

First, Zhu argues, US hegemony will remain a powerful stabilising factor in regulating strategic international competition. No country has a real opportunity to launch into territorial expansion and military adventurism. Second, the values that underpin the international system – free exchange, free competition and open markets – are not being called into question. Third, despite the risk of a protectionist wave, the institutions which provide the framework for free exchange remain sound. Last, relations between the great powers today are characterised by a degree of interdependence without historic precedent. This interdependence fosters cooperation and restricts competition.

According to Zhu Feng, while the financial crisis will not lead to a reversal of the expansion of US hegemony; it signifies, potentially, the commencement of a transformation in global relations of power, and the redistribution of national wealth. Can China gain a share of this? If the financial crisis is the first warning signal of the end of the US hegemony, then would the resulting disarray in the international system not be contrary to China's national interest? This view is largely shared in Chinese foreign policy circles, according to Jiang Yong. But in his view, it rests on a short term vision of Chinese national interest. In quoting the Yijing, he reminds us of the words of wisdom according to which "a decapitated dragon is a happy omen" (群龙无首， 吉, *qunlong wushou, ji*). China is indeed taking full advantage of the current world order to progress its interests. However, it would benefit to a greater degree from a just and rational world order than from a complete breakdown of the status quo. If it becomes apparent, therefore, that a change in structure is in gestation, Jiang Yong believes that China must use all its power to ensure it is present at the birth. On the other hand, if the anticipated change occurs only on a small scale, China must refrain from taking action and be content with operating within the existing limits of the global system.

China has not been spared by the financial crisis, which has interrupted the rhythm of her growth, threatening Beijing's objective of building a "harmonious society". Like the Western economies, China has to confront a narrowing of its export openings and a wave of bankruptcies among its enterprises. Meanwhile, the risk of social instability is greater than in the west. Indeed, the crisis is occurring at a time when the Chinese development model, after three decades of operation, remains based on export-led growth and the attraction of foreign direct investment. The crisis marks the end of this era.

The crisis is revealing the vulnerabilities of the model that led the Chinese Communist party, at its XVIth Congress in October 2002, to designate the coming two decades as a "period of strategic opportunity" (战略机遇期, *zhanlüe* *jiyuqi*). China is lacking the capital and technologies that would enable it to imbue its development with an element of strategic transition. Jiang Yong feels there is no reason to maintain that China's industries will be able to innovate their way out of the drop in their exports. China's leaders require this pressure, however, in order to speed up the process of change to the Chinese development model and to initiate a new phase. For Zhu Feng, this demands brave reforms. Indeed, an upturn in growth as a result of internal demand will require political reforms. Essentially, however, Zhu Feng and Jiang Yong see the crisis as a beneficial jolt to the system, and they pay little heed to the risks. This is no doubt related to their capacity as specialists on strategic matters, which leads them to disregard an approach that would highlight the social implications of the economic downturn.

The global economic crisis shows that considerable risks were taken by small countries like Iceland or Singapore that developed concentrated and globalised financial operators. Major powers, by contrast, can absorb their banks' losses. If the city of New York had been a sovereign state, Citibank would have brought about its failure, but Citibank is an American bank, and it will survive the jolts of 2008. China must now take advantage of this period of turbulence to develop its own financial structures and cease to externalise this sector.

In addition, the US and Europe have had a change of attitude towards China. The relentless pressures on the country to become a "responsible partner" have given way to attempts to flatter and win over China. This change opens up a new space in which China can project its interests into the backyard of the Western powers, in Africa and Latin America. Lastly, New York, London and Singapore's difficulties as international financial centres are providing Shanghai and Hong Kong with the opportunity to assert themselves in the competition to attract share capital.

In these circumstances, while international public attention is focused on it, China must above all seize its chance to strengthen its "soft power". The model of social capitalism along German lines has already been dismissed in view of the low growth rate it provides. The American capitalist financial model has lost all credibility. The Beijing consensus (北京共识, *Beijing gongshi*)[3] seems an increasingly credible alternative for developing countries.

The financial crisis would thus seem likely to have a greater impact on the relations between the major powers than on the reform of global governance. Indeed, the IMF and the World Bank have no effective strategy (束手无策, shushou wuce) to respond to the crisis, which therefore makes consideration of the reform of global governance an urgent priority. That is not where the real priority lies, however. The crisis sanctions the return of nation states and the great powers to regulation of the global economy. Intergovernmental negotiations alone make it possible for the risks to be managed. In this respect, China-US relations are, for Zhu Feng, the key to the future of the global economy.

From this perspective, the onset of a new US administration brings the threat of new uncertainties: will there be sufficient coordination of economic and social policy between the US and China in the short term? The Obama administration is implementing a voluntarist policy, seeking to reduce unemployment via incentives to companies to avoid relocation, and through a programme of infrastructure building. Washington can choose cooperation with China on these measures, which will have a considerable impact on the Chinese economy, and establish a new partnership. Adopting measures without taking Chinese interests into account, however, could have a very negative effect on bilateral relations. Could China become the scapegoat of Obama's attempts to rid America of the Bush legacy (去布什化的替罪羊, *qubushehua de tizuiyang*)?

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As Zhu Feng points out, the decision is not America's alone. The anticipated refocusing of US foreign policy on the fight against global warming could have a significant effect on China-US relations. Indeed, in Zhu Feng's opinion, everything points to the conclusion that Washington will encourage China to play a greater role in these matters, environmental decision making being one area in which China's fate is sure to affect the future of the world. Are the Chinese leaders ready for this type of cooperation?

As the crisis has progressed, China has achieved an important role in the search for political solutions to the financial collapse. Its reserves, valued at 1,900 billion dollars, are an essential tool of influence in international affairs. In addition, it has less to lose from the crisis than the emerging countries and Europe, according to Jiang Yong. Beijing must also draw lessons from the crisis, however, in order better to absorb the next waves that will rock the international economy. In this respect, the government has committed the error of not diversifying its foreign currency reserves. The plan has been in the pipeline for a considerable time, but has never been implemented due

3 Proposed by Joshua Cooper Ramo in 2004, the term "Beijing consensus" appeals to Chinese analysts. He asserts that China has constructed a development model based on its ability to resist external pressure by increasing aggregation of the attributes of asymmetrical power. On the economic level, the characteristic of the Beijing consensus is to aim for more equitable development than the US economy, and not to rely solely on the frantic search for growth in GDP. In addition, the Chinese model is characterised by its ideological flexibility, by the search for pragmatic solutions, and by innovation in managing problems. Joshua Cooper Ramo, *The Beijing Consensus*, The Foreign Policy Centre, May 2004.

to the "pre-eminent interests of the different government structures" (部门利益作祟, *bumen liyi zuochong)*. In reality, China continues to buy Treasury bonds, and diversification does not appear to be on the agenda. China's strategy at this level appears to be one of absorbing the shocks, along with the US, rather than cutting fiscal ties, in order to preserve good bilateral relations and international stability.

2. Gaining abroad: the international expansion of state enterprises

by Thibaud Voïta

Based on:

Li Dongyang, Zhou Xueren, "The strategy of Chinese enterprises: choosing to 'go global' (zouchuqu)", Guanming Ribao, 30/11/08.

Li Wanshou, "Investment in innovation and enterprises with high potential", Business Sohu, 01/12/08.

Li Rongrong, "Recovery to better forge ahead: raising the bar", Speech to the heads of the SASAC enterprises

State-owned Chinese enterprises are less affected by the global economic crisis than their international competitors. Might they take advantage of their government-backed security to secure the assets of US and European multinationals? In the state press (Guangming Ribao), some express their belief that the moment has come to conquer the international market. For the time being, however, the biggest groups seem more intent on gaining strength and, in particular, on accelerating the process of catching up technologically. During the current crisis, the authorities appear determined to gain ground in this crucial area; if and when China's hi-tech capacities improve, international takeovers could follow rapidly.

The government is keen to polish the jewels of Chinese industry, investing money and human energy in order to achieve the two great goals: 1. catching up technologically, which should help propel them towards 2. "going global" (走出去 *zouchuqu*). The predominant view is that the global economic crisis is a risk, but also may be an opportunity for Chinese enterprises.

Li Rongrong's speech is revealing. Li heads the State-Owned Assets Supervision and Administration Commission (SASAC), a shareholder in the main non-financial State-Owned Enterprises – SOEs. In this capacity he is responsible for the largest Chinese enterprises and has the rank of Minister. He recognises that the year 2009 is going to be difficult, particularly for the expansion of Chinese enterprises abroad.

On the whole, notes Li, the SOEs' results for 2008 were good. From January to November, their earnings amounted to 10 760 billion yuan (up 20.2% compared to the preceding year), and 119 SOEs saw an increase in their earnings.

Over this same period, however, profits were 683 billion yuan, down by 26%. 75 SOEs saw an increase in profits. The third quarter was difficult for a number of Chinese sectors: electricity, coal, petroleum, steel, ferrous metals, the light textile industry, construction materials and property. Some sectors experienced considerable difficulties in 2008, though some of these difficulties were not directly related to the crisis: in the case of electricity and petroleum, difficulties related to significant fluctuations in the barrel price and in the price of coal during the year. Li does not provide detailed figures on these two sectors, but we can see that if their figures are taken out of the SOEs' results, profits dropped by only 3% over the year 2008.

These SOEs under the SASAC are, in any case, not at risk: they enjoy state protection. Li makes the case that, at most, the crisis is likely to speed up reforms that are already under way, backed up by SASAC as a shareholder: these reforms relate to mergers (as in the telecommunications sector, or the merger of the Avic I and II aeronautics companies), shareholder structures and the establishment of Boards of Directors, risk management, management, greater innovation, sustainable development, and so on.

Li Rongrong reiterates that while the crisis brings with it inevitable difficulties, it also creates opportunities. It could thus contribute to the achievement of two complementary high priority objectives: the promotion of innovation and off-shore expansion.

The promotion of innovation should make it possible for Chinese enterprises to project themselves onto the international scene. The authorities have always criticised the enterprises for too little innovation. While investment in R&D is constantly increasing, the share of profit devoted to it by enterprises has not increased significantly. Li Rongrong quotes a number of SOEs that have agreed to major efforts to develop ambitious programmes. Among these are the giants Baogang (steel), Huaneng (electricity), FAW (motor vehicles) Shenhua (coal), and China National Building Material Group, which are all recognised as innovative enterprises as a result of the research centres they have established. Li also mentions the most advanced projects, primarily in the transport and energy sectors: high speed trains (Beijing – Shanghai), aeronautics (the ARJ21-700 model), liquefaction of coal, liquefied natural gas, etc.

Innovation has difficulty filtering through to the bulk of enterprises, particularly in the non-state sector[4]. Li Wanshou, head of the state private equity and venture capital fund, the Shenzhen Capital Group, acknowledges

4 See in particular the conclusions of the OECD report, *Reviews of Innovation Policy: China*, Paris: OECD, 2008.

that SOEs struggle to find the funds to support their research. It is therefore urgent that reform of China's financial market be undertaken by facilitating the IPO available to the innovative SMEs and by developing venture capital type funding mechanisms. Reform of this type is said to be under consideration.

In sum, the process of catching up technologically should support China's expansion into foreign markets, and this expansion could benefit from the global economic crisis. Li Rongrong's remarks are clear:

The crisis should make it possible to restructure the economic system and modes of production. The SOEs should use their capacities to strengthen their position in their markets and continue their expansion towards the global stage. They should take advantage of lower costs and launch programmes of acquisition, buying up strategic natural resources, purchase of equipment and key technologies, and of recruitment. At the current time, it is necessary to benefit from the opportunities brought about by the crisis in the transport, electricity, nuclear energy and telecommunications sectors.

It seems likely that the global crisis could result in overseas takeover bids by Chinese groups (primarily the SOEs).

Technological advancement should enable Chinese companies to reach at least an equal standing to their foreign competitors. But how can China's leading industries attain a higher level of research and development? Guangming Ribao, the propaganda publication of the party, starts from the principle that the most advanced technologies come from overseas. There are three possible ways to acquire these technologies:

1. by strengthening technology transfer, despite the reluctance of multinational companies investing in China;
2. by sending Chinese trainees to innovation centres overseas so that they can gain familiarity with the technologies of the future;
3. by acquiring foreign companies in order to obtain their technologies and knowhow.

On reading these different articles, it is possible to identify in broad terms two types of foreign investment undertaken by the Chinese groups:

Countries targeted	***Type of investment***	***Type of activities undertaken by the investing group***	***Objective***
USA, Western Europe, Japan	*Acquisition, Joint Ventures*	*High technologies*	*Acquire technologies and/or take advantage of the market*
Russia, Asia, Latin America, Africa	*Establishment of a 100%-owned company abroad*	*Manufactured products, labour-intensive industries*	*Acquire natural resources and/or take advantage of the market*

In their foreign expansion, however, Chinese enterprises may come up against numerous problems: relatively uninformed about foreign markets and cultures, they have been known to underestimate the risks involved, such as exchange rate fluctuations. It can be difficult for a would-be investor to identify an enterprise that meets its objectives, and then to evaluate its price. Once the takeover has occurred, disputes can occur with the foreign partner. These problems probably explain the current reluctance of Chinese companies to launch takeovers.

Guangming Ribao argues that companies such as Sinosure (a Chinese credit insurance and export insurance company) should assist the Chinese groups to expand overseas. It hopes that export subsidies and credit will be expanded, hand in hand with attractive fiscal policies. It also calls on the authorities to increase the number of trade agreements with other countries through the WTO.

In conclusion, it seems likely that the global economic crisis could result in overseas takeover bids by Chinese groups (primarily the SOEs). In the motor vehicle sector, for example, major Chinese groups like Chang'An, Dongfeng and Chery could soon be welcomed as the saviours of the three American giants – Ford, GM and Chrysler. Rumours abound, meanwhile, of the takeover of Alico, the Asian subsidiary of AIG[5]. Chinalco's investment in Rio Tinto could likewise be seen as the first sign of a coming trend[6]. Yet the Chinese remain relatively cautious, as shown by the reluctance of the Chinese sovereign fund to buy up assets since the beginning of the crisis.

5 Li Fangfang, "'Big 3' look for Chinese medicine", *China Daily*, 10/12/08, "AIG assets sales may be delayed, CEO says", *International Herald Tribune*, 11/12/08.
6 See, inter alia, the articles in the 12/02/09 edition of the *Financial Times*.

3. One crisis, diverging local and national priorities.

by Thibaud Voïta

Based on:
Chen Huan, Li Peng, "The provinces and municipalities throughout the country are putting together investment plans worth 1000 billion yuan", 21st Century Economic Herald, 21 November 2008.

Ye Tan, "What to do with 100 billion out of the 400 billion recovery plan?" Meiri Jingji Xinwen, 21st November 2008.

Xiao Liang, "Local governments, the primary forces to drive the 1 300 billion yuan plan", 21st Century Economic Herald, 3rd February 2009.

So this is China's safety net: a boost of one thousand billion yuan (approximately 100 billion euros). With such enormous sums, China's programme for managing the global economic crisis makes European and American plans look tame. In announcing its findings to the Chinese public in late 2008 and early 2009, Beijing added a further distinguishing feature to its strategy: social investment was declared essential to China's economic stability and growth, with health and education at the top of the list.

The critical Chinese press (21st Century Economic Herald, Editorial 21/11/08) expresses doubts as to the effectiveness of this plan. Beyond the morale-boosting "announcement effects", a tussle between central and local governments is taking shape, with the latter tending to reinforce infrastructural investments of the recent past, rather than embark on a new period of social spending. In addition, there is a widespread need for further reassurance regarding investments that might never have been sanctioned in a different climate. According to critics, the plan is merely a readjustment of the familiar five-year planning schedule, with the crisis used as an excuse to hastily invest enormous sums without fear of the future[7].

The first announcement of the plan came at the beginning of November 2008, with the State Council's decision to launch a 400 billion yuan series of investments in order to underpin growth. Its objective is to support China's consumption and to avoid growth falling below the symbolic 8% mark, whereby the country could be threatened by severe social unrest. Local governments reacted immediately by announcing further investments, and the plan expanded to 1,000 billion yuan. In addition, the total amount calculated by the 21st Century Economic Herald, a south China daily with a reputation for analysis and critical discernment, was several times larger than the official 1,000 billion (see below); it may be that projected long-term investments are taken into account here. Central government got the plan under way by injecting 100 billion yuan at the end of 2008, and announced a further 130 billion investment in early February 2009.

Table 1. Investment programmes in the provinces and municipalities in support of the recovery plan. Note that these figures are considerably higher than those put forward in the plan itself.

Province, municipality	**Total investments announced (billion yuan)**
Shanghai	*500*
Jilin	*400*
Hainan	*207*
Anhui	*389*
Zhejiang	*350*
Hebei	*588.9*
Henan	*1200*
Liaoning	*1300*
Chongqing	*1300*
Guangdong	*2300*
Jiangsu	*300 (2009) and 650 (2010)*
Shandong	*800*
Henan	*1000*

Source: *21st Century Economic Herald*

Ye Tan, a critical editorialist from the Meiri Jingji Xinwen (News Daily), argues that the recovery plan will succeed only if: 1) it meets with market approval and provides advantages to business; and 2) it stimulates household consumption. It is not certain that these objectives will be realised.

The central government had called for massive investment in the health and education sectors on the basis of a Keynesian understanding of the dangers of excessive saving. The Chinese tend to limit consumption in order to safeguard their future wellbeing, putting money aside to compensate for the lack of state-supplied social services. Central investment in education and health, therefore, should free up savings for household consumption. The commission responsible for the plan (National Development and Reform Commission, NDRC) announced at the end of October that these investments should be put as a priority into social services, spending for which would account for 60% of the overall amount (600 billion).
For the time being, as the 21st Century Economic Herald

7 To paraphrase Qu Hongbin, Chief Economist with HSBC, quoted in Keith Bradsher "Chinese Economic Medicine: Roads and Rails", *International Herald Tribune*, 23/01/09.

emphasises, these calls from the central government have not been received favourably by the local governments, whose investment programmes are devoted primarily to infrastructure, in particular transport. Railways and highways predominate in the building schedules of China's provinces, along with electricity supply and property development. These programmes, it should be noted, are not new: they are no more than a revival of the projects launched in the 11th Five-Year Plan (2006–10) and those anticipated in the 12th Plan. According to the 21st Century Economic Herald's estimates, social expenditure represents only 15% of these projects. This assessment is supported by several examples, an outline of which is given below.

An investment package was declared in Shanghai municipality last November which mirrors the projects stated in the 11th and 12th Five-Year Plans, notably in the building of roads[8]. Despite the enormous figures being touted at a national level, such investments represented an increase of only 1.8% over the previous year. Similarly, the province of Zhejiang (to the south of Shanghai) provides for only 10 billion worth of new investments in addition to the projects already planned. Take, for example, the announcement of the railway line between the cities of Suzhou and Ningbo (both close to Shanghai), already provided for in the 11th Plan. At a lower administrative level, the city of Suzhou on 17 November announced investments worth 55 billion yuan, of which 20 billion will be allocated to the construction of two underground train lines.

The NDRC's representatives from Shandong province announced their investment programme on 12 November 2008. 240 projects are foreseen, concentrating on eight primary sectors, with total investments of 800 billion yuan. The transport industry is one of the main beneficiaries, with 27 projects (129.8 billion yuan) including the construction of a railway line along the coast, and the electrification of lines.

Table 2. Projects in Shandong Province

Sector	*Number of projects*	*Amount invested (billion yuan)*
Transport	*27*	*129.8*
Energy	*25*	*140.5*
Rural irrigation	*28*	*97.4*
High-tech industries	*44*	*208.9*
Services	*55*	*96.1*
Remainder (including social services)		*86.5*

Source: *21st Century Economic Herald*

Another example is that of the central China province of Henan, whose local NDRC announced 1,000 billion worth of investments in 2009. Out of these investments, only 40 billion is to be injected into education, employment, rural communication, health or similar areas – that is, about 3% of the provincial plan. On the other hand, environmental protection projects are to receive 50 billion yuan, energy 100 billion, and services 200 billion.

The investments in the autonomous municipality of Chongqing are likely to benefit property development: 300 billion will be allocated to renovation of old parts of the town. Investment in social services is 50 billion (3% of the total).

Despite the predominance of infrastructural investment in the provincial budgets, it should be noted that a considerable number of these projects are yet to receive the approval of the central government, which will evaluate their relevance and feasibility.

Programmes like the ones mentioned leave some Chinese commentators sceptical. Ye Tan believes that such investments will not benefit consumers or business. The most effective mechanism, in his opinion, would be to give these groups a "red envelope"[9] in the form of a tax exemption.

If local governments prefer to invest in large-scale projects rather than in education and health, it is because they are hoping for quick returns on their investments[10]. Their enthusiasm also seems to stem from a desire to invest in sectors that in recent years have been regulated by the central government (as in the macroeconomic control policies enforced by Beijing in 2004). Certainly it should be expected that we will see illegal use of these funds to shore up particular industries in trouble, contrary to Beijing's recommendation.

If local governments do turn out to benefit from the national plan by launching investments indiscriminately, then Beijing has little room to manoeuvre in regulating this trend. It can only be hoped that these investments will not cause macroeconomic imbalances or severe negative externalities such as increased pollution[11].

8 See highways A8, A14, A16 or the Huqingping or Huaxiang roads.

9 Red envelopes are traditionally used in China to pass money to someone.

10 We can see here the various types of investment logic: the central government seeking to make long-term plans in the face of short-sighted localities whose programmes tend to cause inflation. On this subject, see Huang Yasheng, Inflation and Investment Controls in China. The Political Economy of Central-Local Relations during the Reform Era, Cambridge: Cambridge University Press, 1996, 372 pp.

11 For another example of scepticism, see: "What the Chinese Package Means", The Associated Press, 23/11/08. Note that this article quotes from the analysis of the 21st Century Economic Herald of 21/11/08 summarized here.

4. The weakening of Guangdong: in search of a new growth model

by Pierre Nordmann

Based on:

Zhou Qiong and Fu Yanyan, "The difficulties in Guangdong's 'double transfer'", Caijing, 8 December 2008.

Zhou Qiong, "Reforming the Pearl River delta", Caijing, 24 November 2008.

Following several years of slowdown, the southern province of Guangdong has been hit hard by the economic crisis. The crisis has come just as the local authorities were hoping to implement a stimulus plan to transform the province's economic model, which is now all but obsolete. Guangdong, whose coastal region lies between Hong Kong and Macao, is a good illustration of the complex interplay in China between the central government and the provincial authorities when it comes to applying economic strategy.

Historically, the delta region of the Pearl River, which covers 30% of the area of Guangdong and holds 50% of its population, was a pioneer region for the economic reforms of the 1980s. But it was surpassed by Shanghai in the 1990s, and more recently by Beijing and Tianjin. Yet today, the region still accounts for almost 30% of China's total exports.

The region owes its success in part to its proximity to Hong Kong: attracted by the lower cost of labour and the tax incentives of the Chinese government, the entrepreneurs of the former British colony moved low value-added labour-intensive industry there, creating tens of thousands of small and medium-sized enterprises (SME).

Since 2005, this growth model has been running out of steam: the increasing costs of labour and land have reduced the region's competitiveness, with the drop in external demand and the appreciation of the yuan making a difficult situation worse. Moreover, the delta's industries, high consumers of energy and resources, have also been contributing to the degradation of the environment[12].

The provincial authorities, conscious of these limitations, have wanted for several years to shift the delta's economy towards high-tech industries and services. Two paths have been followed: the relocation of low value-added enterprises to the less developed areas of the province, and better linkages with Hong Kong and Macao.

Since November 2008, however, the crisis has hit Guangdong hard, and the authorities have had to reassess policy schedules. The guiding principle is now to support the province's SMEs.

12 "World Bank helps clean up China's Pearl River", China.org.cn, 22 March 2007.

Thanks to the policy of relocation of enterprises, termed "double transfer", the local authorities are hoping to develop the areas in the north, west and east of the province. According to one researcher from the Guangdong Academy of Social Sciences, interviewed by the economic reference journal Caijing, the per capita GDP in these territories is four times lower than that in the delta region.

The idea is to relocate low value-added industries to these regions and to attract high-tech enterprises to the delta, at the same time as promoting labour retraining. Within the scope of this policy, 50 billion yuan (5.24 billion euros) are to be allocated between 2008 and 2012 to infrastructure projects in these regions, to relocation of the industrial hubs and to training, and 2.5 billion yuan (262 million euros) are to be spent on enterprise incentives.

According to several of the Hong Kong media[13], this initiative can be attributed to Wang Yang, a rising star on the Chinese political scene. He has been secretary of the Chinese Communist Party (CCP) in Guangdong since December 2007, and a member of the politburo of the CCP since October 2007[14]. He commissioned and then promoted a daring course of action to integrate the financial sectors of mainland China, Hong Kong and Macao, the centrepiece of which was to be the creation of a pilot zone of financial cooperation between Hong Kong and Shenzhen "by 2010", to which a certain number of legislative powers would be transferred.

> Guangdong province is a good illustration of the complex interplay in China between the central government and the provincial authorities when it comes to applying economic strategy.

However, according to Caijing, since the report was submitted to the central authorities in March 2008, many have questioned the appropriateness of the double transfer policy in the current economic climate. The entrepreneurs, academics and Guangdong government officials interviewed by Caijing argued that the priority for now should be the survival of the enterprises rather than their relocation.

Having announced in November 2008 several measures to support the SMEs[15], the central authorities also are very sceptical of the appropriateness of the "double transfer", which has evidently struck a jarring note. According

13 Bonnie Chen, "Shenzhen mayor pushes twin city concept for HK", *The Standard*, 10 March 2008.
Denise Tsang, "Recalibrating world's production line", *South China Morning Post*, 8 December 2008.
Wu Zhong, "Guangdong looks for closer delta embrace", *Asia Times Online*, 12 March 2008.
14 Fong Tak-ho, "Wang Yang: A rising star in China", *Asia Times Online*, 3 May 2007.
15 "China mulls more support to SMEs amid global uncertainty", *Xinhua*, 6 November 2008.

to Caijing, last November, during a trip to Zhangjiang (a prefecture in the west of Guangdong) Wang Yang announced that the local authorities would not make any effort to save the enterprises in trouble. Indeed, in Wang Yang's words, "the failed enterprises belong to a backward production mode" (落后, *luohou*), and "their removal is a function of the operation of the market".

Two days later, however, the Prime Minister Wen Jiabao, when visiting Guangdong, publicly asked the province to take strong measures to help out any struggling SME. One week later, Wang Yang reiterated his position[16]. Finally, on 1 December 2008, the province announced measures to support the SMEs, thereby toning down the policy of double transfer.

Conversely, according to Caijing, the proposed integration of the delta, in line with the central government's desire to prop up those SMEs which are engaged in export, received the blessing of the central government as early as March.

A codicil to the CEPA (Closer Economic Partnership Agreement) was signed, affording Hong Kong enterprises greater access to the Chinese market on the mainland. On top of this, an agreement was announced to finance the construction of a bridge linking Hong Kong, Macao and mainland China.

The academics interviewed by Caijing, are not optimistic, however. They say the authorities are still far from implementing the institutional changes necessary for the continued integration of the delta.

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16 Wu Zhong, "Regions won't dance to Beijing's tune", Asia Times Online, 26 November 2008.

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