

China has enough trump cards up its sleeve

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On 22 December 1978, the Eleventh Central Committee of the Chinese Communist Party completed its third plenary meeting. There was no contemporary recognition in the West of the significance of the meeting.

Now we are recognising the thirtieth anniversary of the Third Plenum. In the intervening years, China, the lives of its people, its relations with the rest of the world, and to some extent the economic lives of people in the rest of the world have been transformed. China's output has increased proportionately more than ever before over three decades in a substantial economy. The consumption levels of what had been about half of the world's people in poverty have increased beyond the usual ambitions for development. The United Nations "millennium goals" for reduction of global poverty are being met in aggregate mainly through what has been happening in this one country. An isolated, autarchic economy thirty years ago, China since the early 1990s has absorbed around half of the direct foreign investment going to developing countries.

China was the East Asian region's anchor of growth when financial crisis hit its neighbours in the late 1990s. Analysts everywhere, and nowhere more than in my own country, are waiting anxiously to see if China will be the anchor of global growth as the whole world is hit by a United States-centred financial crisis in 2008.

Through the reform period, there has been a transformation of the Chinese mind. Hundreds of millions of Chinese are now part of an international community of ideas and information. Many threads have been woven to produce this result. One was the audacious scale of the early promotion of study abroad. This was carried through in explicit recognition that many students would not return, and on the basis that enough would return or in other ways contribute to Chinese development for study abroad to provide a net gain for the country. Another was the unequivocal early commitment to opening the economy to foreign trade and investment, and its requirement of open movement of business and professional people in and out of China.

Reform in China has not and could never be a smooth or painless process. There have been challenges at every step, some bumps in the road, detours and dead ends.

As it happens, the three biggest challenges have coincided with the decennial anniversaries: the inflationary boom of 1988, which established the conditions for the one political crisis of the reform era in 1989; the East Asian financial crisis of 1998; and the global financial crisis of 2008.

At some time in the third decade of growth, China ceased to be a "neither this nor that economy". It had become a large market economy. Deep integration into international trade and investment had been reinforced by acceptance of far-reaching commitments on entry to the World Trade Organisation in November 2001. The considerable remaining limits on the use of markets were similar in extent and kind to those in many market economies across the world, shaped by the usual anxieties and realities of a market economy, and by political economy constraints with no public policy purpose.

The East Asian financial crisis had made China cautious about the extent and speed of external financial liberalisation. This provided inoculation from contagion out of the United States-led financial crisis of 2007-08. While there was a genuflection to socialism-or reluctance to surrender major areas of patronage and control-in the reluctance to cut the final strands of state control from the large businesses in heavy industry and financial

services, the growth in business ownership was increasingly and overwhelmingly private. The East Asian financial crisis left a legacy of Chinese confidence in the country's capacity to maintain growth through adverse external circumstances that is important in 2008. It also entrenched the role of state-owned businesses in heavy industry, including mining, minerals and energy processing, transport and communications, and the financial sector, and indirectly to the huge surplus savings of the early twenty first century.

Like the second, the third crisis of the reform period had external origins. Or mainly external: near its heart are all of the causes of the massive current payments imbalances between the United States and East Asia in which Chinese patterns of savings have played a part.

China is in a better position to sustain growth through large-scale fiscal expansion through the current crisis than it was at an equivalent stage of the Asian financial crisis. Its current account surplus and foreign exchange reserves are incomparably larger. And the successful Keynesian response of the Asian financial crisis gives all participants in the process confidence that it can be done again. Extensive discussion of the need to expand expenditure on rural development over the past three years has established a foundation for fiscal expansion without wasting resources.

But China will need all of these advantages if it is to maintain strong growth through the current crisis. This external recession is going to be large by any standards. It may push China's export growth near or below the zero rate of the worst period of the Asian financial crisis. Slow export growth may last for longer. Exports now represent a much larger share of the Chinese economy and so have greater leverage over the growth process. And China now has a much more important market economy, in which the normal business cycle of a market economy can exaggerate the initial impact of external shocks.

Growth will be significantly weaker than the average of the reform period over the next eighteen months. But with good policy, China can avoid a major slump, as it did a decade ago.

This is an extract of a speech by Professor Ross Garnaut
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