When senior Chinese economists are asked these days to comment on prospects for continued economic liberalization and reform, they typically respond by addressing a different question: how can China boost its GDP growth to a newly-established target rate of 8 percent annually in 1998 and 1999? Achieving this target is accorded special attention because of the “slowdown” (sic) to 7.2 percent reported in the first quarter of 1998. This response is usually accompanied by emphasizing a massive government infrastructure program of $750 billion to $1 trillion over the next two or three years to assure that the 8 percent goal is reached.

This is not good news for promoting economic liberalization and progress in China. An infrastructure program of such enormous scale, if indeed it were implemented, would preempt for public investment more than 40 percent of China’s gross investable resources. Private and quasi-private investment (including the so-called “township and village enterprises”), which have been the main engines of China’s growth in the past decade, have already been constricted by the predominant share of “policy lending” to state-owned enterprises (SOEs) by the four major state banks. Implementation of an infrastructure-dominated 8 percent growth effort would further squeeze resources available to these non-state businesses.

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Incidentally, but not insignificantly, such resource reallocations would make depreciation of China’s currency more likely because non-state businesses are the main sources (nearly 75 percent) of export earnings, while large scale infrastructure spending would increase demand for imports. This asymmetry would put pressure on the renminbi in China’s foreign exchange market.

But this is only part of the bad news. Fixing a target growth rate as the lodestar for guiding development recalls the rigid practices of failed centrally-planned economic systems in the past. It is a detour on the road to a modernized, open, and competitive Chinese economy.

Chinese policymakers respond to such criticisms with two arguments: first, a growth rate of 8 percent is essential to provide jobs for China’s high and rising number of urban unemployed; and second, massive infrastructure investments are the most rapid and effective means of reaching this target and generating the necessary employment.

This argument is unconvincing. Most of China’s job creation, as well as output expansion, in recent years, have come from non-state enterprises whose share of GDP has risen from one-third in 1985 to over two-thirds currently, while that of the SOEs has fallen correspondingly.

Moreover, while an 8 percent growth target, mainly pursued through public infrastructure investments, would make some inroads on China’s unemployment problem, the results would be temporary and still fall far short of remedying the problems. Many of the resulting jobs could well have the character of “make-work” activities, without enhancing productivity in the rest of the economy.

According to the Shanghai Institute of Foreign Trade, 65 percent of China’s urban population of 400 million are of working age, between 18 and 60. Estimates of unemployment among this 260 million person workforce range widely, from a low figure of 12 million mentioned by President Jiang Zemin in a recent interview, to other official estimates of 26 million (10 percent of the urban labor force), and much higher numbers that purport to include redundant employment in SOEs, plus regular inflows of peasants from rural areas seeking jobs in cities.
On reasonable assumptions about the relationship between GDP growth and employment, a figure of 8 percent growth would apparently contribute appreciably to job creation, perhaps increasing employment between 12 and 17 million. While these effects would be consequential if they materialize, they would not remedy China’s structural unemployment problems. If such increases in employment were achieved through huge infrastructure investments, the resulting employment gains might be apparent and transitory, rather than real and enduring.

Choosing among alternative public works projects typically lacks the benefit of market-based criteria to guide choices. From the standpoint of job creation and recorded growth, building a road from somewhere to nowhere has the same short-term effect as one built from somewhere to somewhere. A newly constructed building with a queue of waiting buyers or leasers has the same effect as one that is nearly bereft of buyers, like the innumerable “see-through” commercial buildings in Pudong and Shenzhen that have created impressive skylines, but are predominantly without occupants.

Moreover, the lack of market-based investment criteria for such an infrastructure program—and rigorous cost-benefit analysis is unlikely to be undertaken to guide project selection if a massive infrastructure program were pursued at a rapid pace—would be an invitation to politically-based choices and to corruption.

This is not to say that China doesn’t need major improvements of transportation and other infrastructure facilities. The point is that overreliance on rapid infrastructure expansion to power a specified 8 percent growth target runs a high risk of building monuments rather than soundly-conceived facilities, and of worsening China’s unemployment problems in the future by well-intentioned efforts to mitigate them in the present.

To remedy China’s formidable unemployment problems in an enduring manner requires continued efforts to liberalize and reform the economy. If China’s economic environment can provide ample opportunities for the emergence of thousands of Chinese entrepreneurs—acting alone, or through township and village enterprises, or through joint ventures with foreign investors—then Chi-
na’s real economic growth will be accelerated and job creation will be substantial and enduring.

China’s good news is that progress in reform and liberalization continues to flourish. Sustaining it should not be curtailed by or subordinated to the demands of an arbitrary 8 percent growth target and a massive infrastructure investment program geared to reaching it.

Postaudit

Whether because of this essay (unlikely) or in spite of it, China’s leaders have lowered their symbolic annual growth target to 7 percent and have become somewhat less fixated on it.