Chinese economic performance: Where's the productivity?

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The Chinese economic miracle is well documented. By any measures, the performance of the Chinese economy over the last decade has been extraordinary. China is now an economic super-power, with great potential for still higher performance levels.

I have seen reports that talk about the Chinese productivity miracle and I was interested to learn whether the economic miracle is built on the back of higher productivity – or just on low productivity, high volume manufacturing.

Luckily, I was invited by the Chinese Association of Productivity Science to attend an International Forum on productivity development in Beijing last November and this gave me a chance – both in formal sessions and in background discussions – to explore this issue. There were only six 'Westerners' present (out of a total audience of about 200) and I think this made the Chinese exceptionally (and to me at least, surprisingly) frank.

The forum turned out to offer a comprehensive assessment of both the productivity gains made by China in recent years, and the productivity challenges lying ahead.

The presentations covered all parts of the Chinese economy and all industry sectors – from agriculture through manufacturing and transport to services. Clearly, China has made its mark on the world economy, especially in its capacity as being 'the factory of the world'...future growth is being driven by the aspirations of individual Chinese (and collectively by Chinese society) to rise through the ranks of developing nations to reach the top tiers. It is also driven by the continuing rise in the population which creates a growing market.

However, already the Chinese have learnt that the status of a global manufacturing centre cannot provide sufficient employment for their growing population, (remembering also that continuing productivity gains ironically mean fewer jobs). There are plans being made to move through a 'manufacturing service' economy (growing services such as maintenance, design, re-manufacturing, recycling, etc) towards a more service based economy.

So is China a high productivity economy? Certainly not. China's labour productivity is about five per cent of that of the highest productivity nations (such as the US and Japan). This is partly because China has had until now, a policy of full employment. This is an understandable aim, particularly in a centralist society. However, some are now starting to question this policy. There were calls from one of the speakers to move to a policy of effective, rather than full, employment – relying on economic growth to create new, value adding jobs.

Some of China's current areas of concern arise from the recent growth. The next 'Five Year Plan', covering 2006-2010, expects an average growth rate in GDP of more than

eight per cent resulting in a GDP per capita rate of over 2000 US dollars. Of course, growth so far has not been equally spread over the whole country, tending to have been concentrated in the East. The government has recognised that the central and western areas need to 'catch up' and major investment is going into the transport infrastructure in these regions to facilitate this.

Similarly, there is an understandable move towards urbanisation. China's attempt to address this is based on a policy of giving 'mega-cities' responsibility for the development of their surrounding region, covering both urban and rural development. (This policy seems similar to the current move in the UK to establish 'city-regions' to establish holistic development planning over both urban and rural areas.)

Growth has been so fast and China has 'modernised' at such a rate, that not all the infrastructure has kept pace. Fiscal policies and instruments (relating to asset ownership, foreign ownership of Chinese companies, corporate governance, taxation of the self-employed, etc), are still being developed to meet the evolving market economy.

This market economy is shown by a recent OECD study (September 2005) which suggests that the value-added share of private enterprises across the whole economy surpassed 50 per cent early in 1998, and the share of private enterprises in non-agricultural sectors reached 50 per cent in 2001 (and 57 per cent in 2003).

There were honest assessments of some of the things that China has done less than well in its race for 'progress'. They recognise, for example, that many recent buildings have been constructed hurriedly – and to poor quality standards – resulting in excessive energy consumption when in use.

This environmental concern came through in a number of the presentations – again honestly recognising that there is a tricky balancing act between economic development and protection of the environment and husbanding of resources. However, some of the presentations addressed this issue specifically suggesting that a change of view (a paradigm shift?) can bring a realisation that these aims are not necessarily contradictory.

One particular interesting presentation from Li Jingwen, who is a fellow of the World Academy of Productivity Science, related to the use of natural resources. The argument was that China has historically had low energy prices. These result in low manufacturing costs but relatively profligate use of energy resources. The low manufacturing costs – and subsequent low pricing of goods - result in high export levels but accusations of 'dumping' by foreign nations. Thus, the low energy prices are both wasteful and cause 'political problems'. Mr Li is recommending that China increases its energy prices significantly but he recognises that this will be unpopular with those currently making profligate use of energy – both in business and to run the many 'gas-guzzling' cars on Beijing's roads.

China has some particular cultural phenomena that help its economic growth. For example, over the last 10 years the average savings rate has been 40 per cent of income. This creates a huge opportunity to fund expansion.

China recognises that it is not an 'innovation nation'; it imports rather than creates technology. In fact, it even fails to 'absorb' technology – continually re-importing as external technology develops. This is recognised as a particular problem and (small) steps are being taken to encourage knowledge transfer from universities to industry – something which rarely seems to take place currently.

The current set of 'research projects', reported on at the Forum, come to an end in May 2006 and will be reported to the State Council so that they can help the early stages of development of the next 'Five Year Plan'. (China works on a sequential series of such plans and the process of creating them is of major significance in shaping government policy and investment.)

Conclusion

It seems as though the meteoric rise in the Chinese economy is a marriage of political will, inherent entrepreneurism, the availability of natural resources and the availability of cheap labour. If one compares this to the UK at the start of the industrial revolution, only the political will is an additional factor – but it is a most important one. China has to catch up fast – it has a growing population to feed. It cannot grow without massive central planning, especially of the infrastructure.

It does seem to have all the ingredients in place to play 'catch up'. In fact it has already caught up with most of the East and is moving its target to the West. It has a massive productivity gap to make up, and it has to make it up carefully to balance a rising population with the falling labour requirements of higher productivity processes; growth has to fuel more jobs.

We shall all be aware of China's progress over the next decade in general terms, but it will be worth keeping a more detailed eye on the productivity and environmental movements. The next World Productivity Congress is in Shenyang in China in October 2006. (See *http://worldproductivtycongress.com* for details)This will be a useful 'observation point'.