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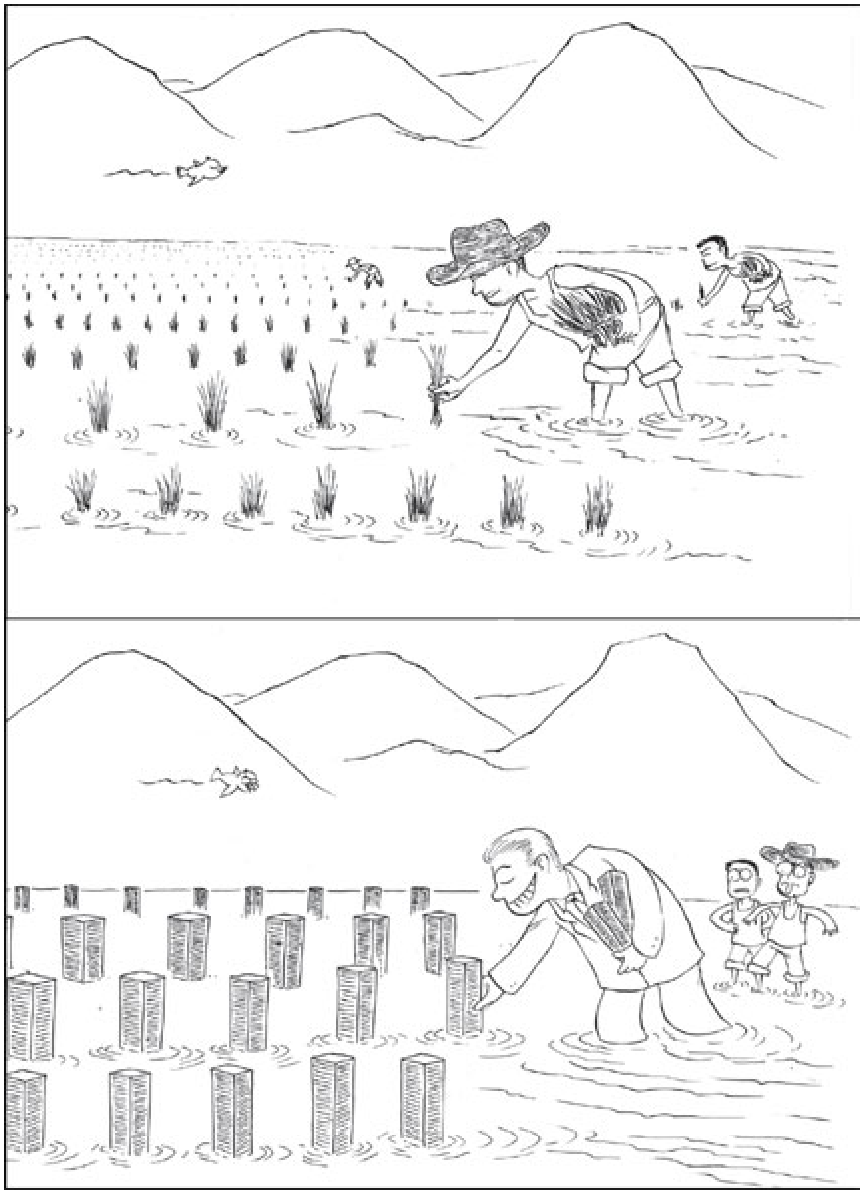
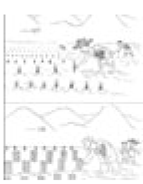


Illustration by Zhou Tao



Too much focus on big GDP and big firms

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THE Econometric Society is an international organization of economists who apply quantitative methods to various issues. The 2010 World Congress took place in August in Shanghai.

The congress, which meets every five years, devoted a panel discussion to the outlook for the Chinese economy. Panelists include Justin Lin, chief economist of the World Bank; and Yingyi Qian, dean of the Tsinghua University School of Economics and Management.

It is not only China's sustained economic growth since Deng Xiaoping launched economic reforms in 1978 that is remarkable; China's quick recovery from the sub-prime financial crisis is equally remarkable.

What about China's future? Many economists have been puzzled by an apparent contradiction between China's fast economic growth and the poor state of its legal institutions.

Professor Qian explained that, on a per capita basis, China is still relatively poor. He pointed to a strong correlation between per capita income and institutions.

In his view, China's institutions are still weak because it is a relatively poor country. (Professor Qian's reasoning bordered on reversing the accepted logic and implying that good institutions are an outcome rather than a determinant of economic growth.)

My own research (with my National University of Singapore colleague Lu Yi and Hong Kong University economist Zhigang Tao) suggests a more nuanced view.

China's economic growth was relatively faster in areas with relatively better institutions. The most prominent of these were the six special economic zones (SEZs) - Hainan, Shantou, Shenzhen, Xiamen, and Zhuhai in 1980 - with Pudong added later.

The genius of former leader Deng was to recognize that China's pool of policy making and managerial talent was limited.

So, rather than spread the limited pool thinly over the entire country, China would get much better returns by concentrating its resources.

This year marks the 30th anniversary of the special economic zones. They were as much an experiment in policy as a rational concentration of limited human resources.

What about the future?

Economists do worry that in the course of China's recovery from the sub-prime financial crisis, the process of economic reform had stalled, and in some dimensions, even reversed. Going forward, these handicaps might curtail the country's future economic growth.

One concern is the thinking that the government should increase its ownership of the economy to more effectively control the macro-economy.

China's 4 trillion yuan (US$594 billion) stimulus included funneling large funds to state-owned enterprises. State ownership has increased at the expense of private enterprise.

State-owned enterprises are useful for their quick response to orders from the central government. However, greater state ownership can increase micro-economic distortions.

With their government financing, state-owned enterprises can more readily engage in inefficient activities. For example, in recent months, state-owned enterprises have been the top bidders in property auctions, fueling already overheated real estate markets.

GDP fetish

Another concern is that, in recent years, the central government has focused too much on GDP growth.

Chinese government officials, whom I recently taught, were very clear that GDP growth was their KPI (key performance indicator). They had certainly mastered Singapore government acronyms!

This single-minded focus on economic growth has resulted in large societal and economic costs.

One cost is the human toll on 200 million migrant workers living away from home, without access to education and social services.

Another is the obvious degradation of the environment through air and water pollution. Still another cost is the rush to convert land from agriculture to industrial and residential use.

Until now, the central government's approach has been to variously use prohibitions and exhortations to keep provincial and city governments to national policy.

This approach has not worked.

For instance, the central government does not allow local governments to borrow. So, taking a leaf from Western investment banks, local governments set up special purpose entities to borrow from banks.

As of June 2010, there were over 8,000 such entities with total borrowings of 7.7 trillion yuan.

China is now firmly back on the path of rapid economic growth. It is time for the central government to shift towards assessing the performance of all levels of government by a balanced scorecard.

The balanced scorecard would account for all important societal and economic goals, and not just GDP growth. It is a more effective approach than relying on a panoply of prohibitions that leave loopholes for local governments to exploit.

(The author is a Lim Kim Sanprofessor at the Business School, and professor of economics and information systems at the National University of Singapore. The opinions are personal. Shanghai Daily condensed the article.)