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Business

It's China's turn to put a halt to our recovery

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Investors worry more about China's slowdown than about Federal Reserve Board chairman Ben Bernanke's "taper", according to a recent informal poll.

Goldman Sachs expects the Chinese economy to grow 7.4% this year. That's way down from 10.4% in 2010, 9.3% in 2011 and 7.8% last year. If the investment firm is right — others put this year's figure as low as 6% if the regime really means to engineer a credit crunch — this will be the first time since the 1997 Asian crisis that China does not hit its central planners' target, a relatively modest 7.5%.

And it might be the year a slowdown in China is felt in America, aborting our fragile recovery. But only perhaps; the recovery here has increasing support from the housing sector and rising consumer wealth and confidence, which is what prompted Bernanke to discuss plans to tighten monetary policy if the recovery picks up a head of steam. That important "if" escaped the notice of most traders, who scurried to the bond and share market exits.

President Obama was the first to threaten the recovery; he raised taxes. Next came the Republicans in Congress; they cut spending, tightening fiscal policy too much and too soon. Now it is China's turn: President Xi Jinping ordered a credit squeeze — the People's Bank of China (PBOC) is not an independent central bank — to stifle conspicuous consumption by the party elite and their offspring and rein in excessive, risky lending by the shadow banking sector. That includes everything from loan sharks to pawnbrokers and leasing companies to trusts (rather like hedge funds). Although the bank decided last week against visiting on China its own Lehman moment and relaxed the credit strangle that dried up interbank lending, the message is clear: "End excessively rapid expansion of credit or, as we have demonstrated, we can make you wish you had." Right now, private sector businesses are scrambling for cash.

Pause here and heed this warning.

Chinese statistics are not as informative as they might be. The cooking of books is a Chinese culinary skill that results in flawed information being fed to analysts, who have difficulty digesting it. China's premier, Li Keqiang, has delicately described his country's GDP figures as "man-made"; Kevin Jianjun Tu, a senior associate at the Carnegie Endowment for International Peace, calls energy sector data "increasingly questionable". The Heritage Foundation's Asia expert, Derek Scissors, is less delicate than Li: "The State Statistical Bureau ... never reports a genuine unemployment number ... Housing prices, non-performing bank loans and coal production ... disappear from view when outcomes turn sour ... [GDP]numbers are virtually useless."

Still, China watchers are obliged to take a guess at what is going on in a country that David Shambaugh, the professor who heads George Washington University's China Policy Program, tells us is the world's second-largest and for 20 years its fastest-growing economy, and its largest merchandise exporter and second-largest importer and recipient of foreign direct investment.

These and similar statistics, more or less plausible, should give you some idea why policy makers everywhere worry that if China sneezes, the rest of the world will catch a cold.

Here is what seems to be going on as the new regime gets its feet under the desk. And many desks there are in a centrally directed economy in which the government decides which state-owned enterprises get credit for expansion, and provides subsidies to 90% of the 2,400 companies listed in mainland China, according to Hithink Flush Information Network, a provider of financial data.

The powerful National Development and Reform Commission employs 30,000 bureaucrats to implement the regime's industrial policy, Wang Kan, a professor at the Institute of Industrial Relations in Beijing, told Bloomberg Businessweek. Those subsidies, up 23% last year, account for 30% of industrial output, according to Usha and **George Haley**, professors at West Virginia and New Haven universities respectively. Don't let the commission's name fool you — reforming itself out of business is not as high on its list of priorities as reforming the economy seems to be for Li and Xi.

The premier and the president know that excessive credit expansion has its roots in the central bank's willingness to pour money into loss-making state-owned enterprises (SOEs) that are inefficient and generally operate in sectors suffering from excess capacity. They know, too, that the shadow financial system recycles money it borrows cheaply from state banks into risky financial products. And that if their plans to liberalise the economy are to succeed, if they are to make credit more responsive to market forces, they must take on powerful institutions — banks, SOEs, local officials who direct credit to well-connected individuals and firms, often in return for the bribes that fund ostentatious displays of haute couture and flash cars by party elites, to the annoyance of the still-poor masses.

Experts disagree on the extent to which Li and Xi are willing to rile the regime's power brokers and risk the political liberalisation that would inevitably accompany a surrender of the power of life and death over China's most important economic players.

Besides, it is not at all clear that Li's version of market reform bears any relation to that term as it is understood in democratic market economies. Li has ordered government departments to develop plans to move more than 100m Chinese into cities from rural areas over the next decade. This is a stimulus programme, Chinese-style, aimed at creating investment, jobs and, according to Li, "a new type of urbanisation that puts people at its heart".

Urbanisation will run alongside Xi's programme to have officials attend self-criticism sessions and go to the countryside to learn from the peasants; at least, from those that have not been relocated to new urban areas.

If this great leap forward fails to stem the decline in China's growth rate, several economies around the world might be among the victims. ? Irwin Stelzer is a business adviser and director of economic policy studies at the Hudson Institute stelzer@aol.com

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