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China Must Adjust Model to Succeed

By ALAN WHEATLEY

BEIJING — Beijing frets that the global economic slump is exacerbating unemployment. So it is. But the main culprit for the lack of jobs is China's own development model.

The conventional image of millions of Chinese hunched over sewing machines and workbenches churning out the world's T-shirts and toys conveys the impression of a labor-intensive economy drawing on a bottomless pool of workers.

Only up to a point. A striking characteristic of China's economy is that it devours capital at an ever-growing rate, thereby capping job growth, reducing labor's share of the economic pie and depressing household consumption — one of the major macro imbalances that underlay the global financial crisis.

"We have long maintained that China's growth is capital-intensive and doesn't create as many urban jobs as a different type of growth would have done," said Louis Kuijs, an economist with the World Bank in Beijing.

The bank estimates that China's capital stock climbed to 295 percent of gross domestic product in 2008 from 248 percent in 2000, underlining just how much China's double-digit growth this decade has been powered by capital spending.

Making the economy even more lopsided, households in China do not share much, if at all, in the fat profits that state-owned firms make with their subsidized investments. This helps to explain a plunge in the share of wages in national income to just 39.7 percent in 2007 from 52.8 percent a decade earlier.

With income growth stunted, it is little wonder that Chinese households consume less as a percentage of G.D.P. than any other country, just 35.3 percent last year.

To be sure, urban job growth has averaged 3.8 percent a year since 2000, according to the National Bureau of Statistics, but Mr. Kuijs said China had generated fewer jobs than, say, South Korea or Japan did at similar stages of development.

"The view that China could have done better in terms of job creation still stands, and that is something that the authorities should try to change," he said. "If anything, the motivation for it has been strengthened by the crisis."

True, high output and subpar employment imply gains in labor productivity, the ultimate key to rising living standards.

“Nevertheless, the low rate of employment growth is clearly a concern even to the Chinese authorities, as it has implications for economic but also social stability,” said Eswar Prasad, a professor of trade at Cornell University.

An estimated 23 million migrant workers lost their jobs in construction and export factories as a swoon in the property market coincided last winter with a collapse in foreign demand for Chinese goods.

The ensuing unrest feared by the authorities has been conspicuous by its absence. Still, officials regularly describe the job market as grim and grave. A government group last year estimated China’s unemployment rate at 9.4 percent, more than double the 4.3 percent rate in June for urban registered jobless.

The gap between job demand and supply will increase further from 2008, Yin Weimin, China’s minister of human resources and social security, said last month.

So what needs to be done?

First, China should stop favoring capital-hungry heavy industries, which benefit from cheap loans from state-owned banks, an undervalued exchange rate and underpricing of key inputs such as land and energy.

The relative importance of manufacturing typically shrinks as economies mature, but in China, industry’s share has risen to 48.6 percent in 2007, from 47.9 percent in 1978, when economic reforms began.

Another statistic illustrates Beijing’s love affair with heavy things you can drop on your foot: Industry and construction added 45.5 million jobs from 2003 to 2007, while employment in services grew by only 31.1 million.

Second, Beijing should replicate the path of reform it followed in industry and allow private and foreign firms to compete with state giants that dominate services like banking, transport, telecommunications, logistics and media.

“You have a monopolistic services sector completely dominated by the state, with entry barriers preventing others from coming in,” said Yolanda Fernandez-Lommen, an economist at Asian Development Bank in Beijing.

The share of services in G.D.P. has increased, to 40.1 percent in 2007 from 23.9 percent in 1978, but for a country at China’s stage of development, the figure should be around 55 percent, Ms. Fernandez-Lommen said. In the United States, it is about 80 percent.

The aversion to services is a legacy of central planning, which frowned on any economic activity that could not easily be quantified. The bias persists even though services generate many more jobs than industry for every dollar of investment.

If China were to invest in human capital and technology to increase productivity, a shift toward services could create more than 100 million jobs by 2025, according to McKinsey Global Institute, the consulting firm's economics research arm.

"Services will need to fill the employment gap that China's industry-focused model has left as well as to boost incomes," a recent McKinsey Global Institute report said.

Recalibrating China's model to create more jobs is easy on paper. In practice, it will be fiendishly difficult politically. It would require Beijing to ease administrative controls that make it hard for rural Chinese to move with their families to cities, where they would generate demand for services.

It would mean weaning state-owned industrial firms off myriad subsidies and making them disgorge more of their profits as dividends. It would also mean ending the monopolies or oligopolies of state firms in services.

"That is hard to tackle, because you have a lot of interest groups and the state-owned sector has a big influence on policies," said Wensheng Peng, chief China economist at Barclays Capital in Hong Kong.

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