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Will China's Consumers Save the World Economy?

By Michael Schuman / Xi'an

A Wuling minivan dealership on the outskirts of the western Chinese city of Xi'an provides hope for the future of the global economy. On an ordinary Wednesday morning, customers steadily stream into the showroom, briefly open and close the doors to the displayed minivans, manufactured by a joint venture between General Motors and two Chinese carmakers, and then march over to the front desk to plop down their money. While salesmen in the U.S. struggle to move cars off their lots, Xu Zhanrong, the deputy general manager of the Xi'an dealership, can barely keep the Wulings in stock. Sales are up some 40% this year, Xu says, with about 50 customers a day driving off with new minivans. "From what I see, people are changing very dramatically," Xu says. "Before people thought: I only buy what I need. Now people are starting to spend for a better or more comfortable life."

Xu's words should be music to the world's ears. As debt-laden consumers in the U.S. retrench, increasingly wealthy Chinese consumers could become one of the most important sources of growth for the global economy. Shoppers in China are opening their newly stuffed wallets wider than ever. Passenger car sales surged 76% in October from a year earlier, while overall retail sales jumped 16.2%. Such spending has contributed to China's robust recovery from the global economic crisis. Gross domestic product grew a hefty 8.9% in the third quarter from a year earlier. (See TIME's photoessay "The Making of Modern China.")

There is reason to believe such eye-popping spending can continue. As more regions of China's vast hinterland join in its amazing economic boom, more and more of the country's 1.3 billion people can afford cars, refrigerators and flat-panel TVs items not too long ago considered luxuries for a fortunate few. Chen Baogen, Xi'an's mayor, says his city of eight million had lagged behind towns on the export-oriented coast, but now incomes are growing to the point where consumption is taking off. In the first nine months of 2009, retail sales in the city increased by 19%, well above the 14.8% growth posted in China's cities nationally. "Xi'an has reached a very important development stage," Chen explains. "Incomes are just at the first point when people can buy homes and cars."

Yet whether or not they will buy remains an open, and crucial, question. Even though Chinese are becoming wealthier, they are actually saving a greater percentage of that new wealth. Cornell University economist Eswar Prasad figures that China's average urban household saving rate reached 28% of disposable income in 2008 — 11 percentage points higher than in 1995. As a result, the role consumer spending plays in China's economy continues to head in the wrong direction. Private consumption accounted for a mere 35% of GDP in 2008, down from 46% in 2000. China's ratio stands at about half that in the United States, and even trails the level in comparable emerging markets, such as India, where the share is 57%. What those figures tell us is that Chinese consumers may be spending more, but not nearly enough to ensure sustainable growth for the Chinese economy down the road. "The consumer revolution already has been happening, but it could be much, much better," says Yuwa Hedrick-Wong, an economic advisor to MasterCard Worldwide. (See TIME's photoessay "Mass Transit: The Best-Selling Cars in China.")

The problem, says Hedrick-Wong and other economists, is that the average Chinese still faces too much uncertainty about the future to spend more freely. China's social safety net systems remain weak, forcing Chinese families to squirrel away large sums to care for elderly parents, pay rising medical bills and prepare for retirement. Aware of the problem, the Chinese government has been taking steps to beef up welfare programs to alleviate the financial burden faced by Chinese families and loosen their purse strings. Beijing, for example, is undertaking a three-year, $125 billion program to build hospitals and clinics to extend healthcare to 90% of the population. Along with these very long-term efforts to boost consumer confidence, the government has also implemented short-term measures to spur on spending. Car sales this year have been boosted by tax breaks and China's own "cash-for-clunkers" program. Xu Zhanrong's Wuling minivan sales have been helped along by a special 10% rebate offered on certain vehicles to residents of rural areas, who make up a majority of Xu's customers.

(See TIME's photoessay "China Rebuilds.")

(See TIME's photoessay "China's Electronic Waste Village.")

Yet economists say Beijing's measures aren't going far enough. Huang Yasheng, professor of political economy at the MIT Sloan School of Management, says that the government needs to do much more to accelerate the income growth of poor Chinese if consumer spending is to play a bigger role in the economy. The average Chinese, he says, doesn't have as much cash to spend as many people think. Actual household income per capita is only about half of GDP per capita, compared to 80% or more in other major economies, placing "a cap," Huang says, on consumer spending. The problem is that income growth among rural dwellers and migrant workers badly trails that of residents of the major urban centers creating a mass of 900 million people who still tend to be very heavy savers. Huang suggests that China needs to act aggressively to boost rural incomes, by, for example, extending banking systems deeper into the countryside to give farmers better access to credit to start small businesses. MasterCard's Hedrick-Wong argues that China should also open up service industries now dominated by large, state-owned companies, such as finance, to allow new entrepreneurs to flourish, creating more jobs with higher wages.

Such efforts will take years to bear fruit, however time the global economy may not be able to afford. Economists agree that China and the United States must alleviate the imbalances that contributed to the current crisis if the world economy is to find renewed, and healthier, growth. China saves too much and spends too little, leading to giant surpluses and hard currency reserves, while the U.S. saves too little and spends too much, creating giant deficits and debt. Unless China can transform its citizens from savers to spenders, the reform of the entire world economic system could suffer. "I don't see any evidence" that China's economy is rebalancing, MIT's Huang says. "Its always difficult to get consumption to grow in a limited period of time." Greater consumer spending in China could have a big impact as well on the world economy. Cornell's Prasad figures that if China can increase growth of private consumption to 20% a year (much higher than the trend of nominal GDP growth of about 15%), global GDP growth would get a meaningful 0.25% boost. (See TIME's China covers.)

With so much on the line, the subject of "rebalancing" will likely get top billing during U.S. President Barack Obama's November visit to China. President Hu Jintao and the rest of China's top leaders clearly agree with Washington that the country's consumers need to spend more. Pressure from Obama to speed that process along by, for example, continued improvements in China's social safety net, might be met with nods of approval. But Obama will only be able to press Beijing so hard. China's policymakers are still wedded to supporting the country's valuable export industries. Any suggestions from Obama that would result in a drastic shift of the economy away from exports and towards heavier reliance on domestic spending will be less welcome. The most sensitive of these issues may be China's currency regime. Obama will probably try to cajole Beijing into allowing the yuan to appreciate, thus making Chinese exports less competitive. But economists doubt China's leaders will take drastic steps to reform its currency system anytime soon.

But perhaps there is reason for optimism, thanks to Xi'an residents like Lu Bo, shopping one recent evening for a new fridge at a Suning appliance store. The 32-year-old, who works as an salesman in the air-freight department at China Eastern Airlines, says his salary was reduced by a third last year when his company was hit hard by the financial crisis, but that hasn't stopped him from spending. With China's future so bright, he doesn't worry too much about saving for the future. "Judging from my job, my life, I think everything will become better and better," Lu says. And maybe for the entire world economy as well.

With reporting by Chengcheng Jiang / Xi'an

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