

What Should We Learn from China?

The strategy

- China's development strategy since 1978
 - Focus on export zones, de-emphasize rural business development
 - Aggressive recruitment of FDI
 - Repressing consumption
 - Under-valuing the currency
 - Heavy investment
- Separating companies from their direct subsidies, giving companies the freedom to go to market
- Creating structures to integrate and strengthen corporations

Policies

- Special zones for exporters with more relaxed policies, including trading rights for companies in the zones
- Gradual socialization of the costs of social security to enable labor mobility
- Separation of financing from direct government control
- Greater autonomy and regional integration for companies

1980s

- Vast expansion in number of companies, as government withdraws subsidies and permits market activities
- Government takes generous attitude toward privatization of state companies as long as they do not lose money.
- Regulatory apparatus becomes enfeebled. Government makes strategic decision to “regulate, not manage”

Separation of Responsibilities:

Local entrepreneurship, central investment

- How local governments solved their funding problems
 - Turning land into capital
 - New financial vehicles
 - Speeding urbanization
- Meanwhile, the central authorities devised industrial plans and development zones to direct capital

Turning Point

- The Great Reversal: 1990s
 - Central authorities fear loss of control, determine to restructure a “socialist market” economy
 - But they do so without relaxing, in fact, while strengthening autocratic control
 - Ultimately, this leads to the historic reforms of 1994 and 1998. These essentially privatized the functions of local government and, at the central level, socialized the costs of government privilege, creating an engine for massive corruption
 - Strengthened and better financed, the central government turned to massive investment schemes to legitimize itself, build patronage links, and generate economic growth.

The Turn: 1989

- Decline in rural businesses in 1990s, movement of rural labor to the urban manufacturing bases.
- Rural income growth through 1990s fell to less than half its rate of growth in 1980s
- Credit to rural areas was largely cut off in 1990s, as the RCCs were turned to government control.

Stepping up the game: 2008

- When the U.S. had its financial crisis, China reacted with a step change in the deployment of massive capital investment.
- The stimulus program had the effect of reverting economic control to the central government.
- In turn, this lowered the returns on investment
- Over time, the unleashing of new capital created a proliferation of new institutions, which have directed capital into more and more speculative areas
- Governments share a pro-cyclical bias toward more credit, more growth, more bad debt
- Asset prices have inflated

Growth in financial services out of proportion to the economy

- The debt growth and asset bubble have stretched to the breaking point, and a debt crisis must occur.
- After the crisis, China could grow very slowly for a very long time, or it could crash.

What China Has Accomplished



- Average GDP growth of 9-10% for three decades (with a few bumps)
- Infant mortality fell from 47/1,000 in 1980 to 33/1,000 in 2000.
- Life expectancy rose to 71 years in 2010 from 68.5 in 1980, 63 in 1970, 45 in 1960.
- Diets improved, protein consumption up ~500% on average
- Mobility grew and with it social controls slackened. Chinese people got more autonomy.

And what it has sacrificed

- Eroding health
- Eroding education
- Deteriorating natural environment
- Equality: Gini coefficient now at .64: hideously high

Education

- Sharp increase in illiteracy from 1990-2000, from 6% to 11% of the adult population (Huang Yasheng)
- Public spending on education 2.4% of GDP. Private share of financing for primary school rose to 74% by 1994 (Pei, 2006).

Health

- Basic health coverage fell 1979-2003 from 70% to 20% of rural population
- Child mortality rising, especially for girls: infant mortality rising 0.5% annually. (Huang, 2010)
- Hospital utilization rates drop with higher costs.

Environment

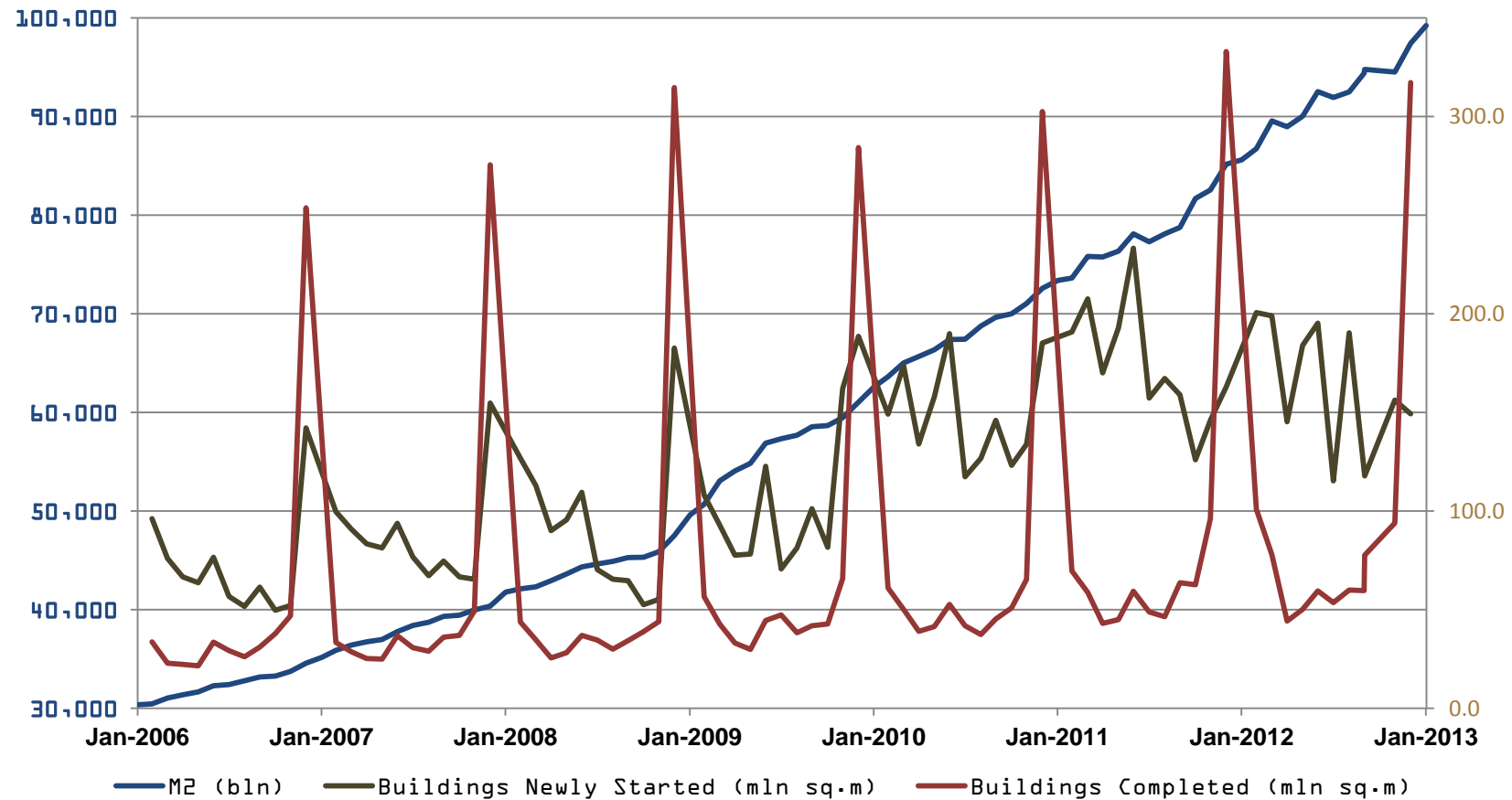


- 70% of groundwater in urban areas contaminated and deemed dangerous
- Most polluted cities on earth, PMI days regularly over 300
- High death toll from contaminated food, water, and industrial accidents

Housing Policy

- 1950: 5.5 m² of living space per urban resident
- 1985: 6.1 m²
- 1998: 17.8 m²
- 2005: 26 m²
- 2005: 81% of urban Chinese families own their own housing units
- China currently building about 790 mln m² in residential housing/year, against new household formation of about 7 mln per year.

Building now is much out of proportion to underlying demand



Questions

- How effective have the industrial plans been, and should Mexico adopt them?

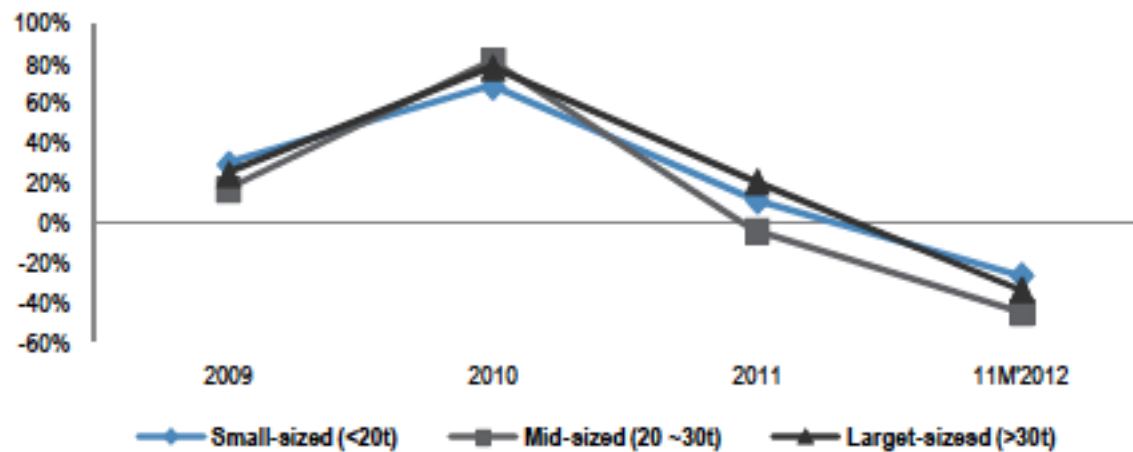
Quantifying the Costs of the Industrial Policies: Example: Machinery Manufacturing

- 2006: ¥900 mln in funding from the central government
 - 100 mln earmarked to support R&D
 - 300 mln for loan-interest reductions for technically qualified machinery exporters
 - 500 mln is to support the overseas commercial activities of small and medium-sized Chinese machinery enterprises
- Unspecified preferential loans from Exim Bank and CDB.
- Land grants and tax reductions from local governments
- Preferential construction of infrastructure to support machinery-oriented industrial parks

Construction Machinery Now



Excavator sales
2009-2012



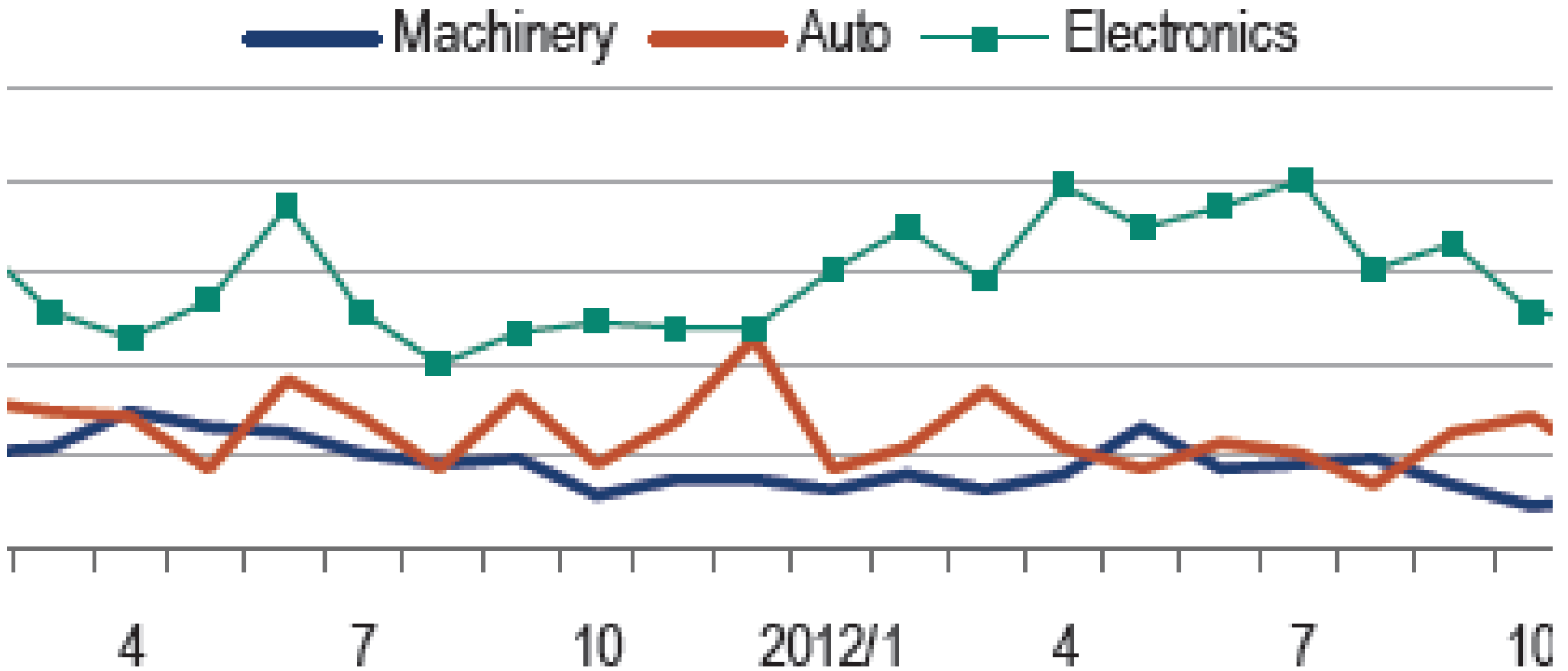
Current State of Machinery Industry

- Construction machinery:
 - China took share massively from CAT and Komatsu, undercutting them on price by 40% or more.
 - Zoomlion, Sany, Lonking, and XCMG dominate the China market. Japanese, Korean, and US manufacturers share about 20%. Chinese have made small moves toward export market.
 - Prices have fallen dramatically.
 - However, sales are increasingly reliant on credit
 - Utilization low, sales dropping, largest player, Sany, in financial peril.

Machine Tools

- By 2010, China had overtaken Japan to become the largest manufacturer of machine tools, with one-third of the world's output and nearly one-third of consumption.
- Exports grew 38% CAGR 2003-2008
- However, China lacks high-end competitiveness and is a net importer by value.

Machine Tool Orders



Questions

- Is China's development model more successful than others?
- Is it possible for Mexico to emulate some parts of it?
- What kind of relationship should Mexico seek with China?