

CHINA'S FOOLISH MIRACLE

BY P.J. O'ROURKE

The Chinese economy has grown amazingly over the past two decades. But what, exactly, has been growing?

I was in Shanghai last June to attend an academic conference on free-trade. (The Chinese think other countries should have it.) One of the economics professors at the Chinese university sponsoring the conference took us on a bus tour of Pudong—the “New Area” being built just across the Hangpu River from Shanghai. Pudong is a mixed-use development meant to contain industrial, commercial, and residential zones. The Chinese government and overseas investors have spent more than \$30 billion on Pudong's new buildings and infrastructure.

We traveled from downtown Shanghai through a homemade-looking tunnel and arrived in a flat, planned sterility of immense dimensions—the office park as Nebraska. Here and there the landscape was decorated with blandly abstract corporate art.

The professor seemed to be a reasonable fellow. He didn't actually criticize Pudong, but he winced as he explained it. He pointed to ranks of new condominiums, spartan-looking with their plexiglass-screened sunrooms and window-mounted air conditioners. He said that these sold for 100,000 to 200,000 U.S. dollars. Or rather, didn't sell. Almost all the units were vacant. “Why are these buildings empty?” The professor: “Overbuilding and overpriced.”

Multinational logos were visible in every direction. Impressive edifices bore the names of Hewlett-Packard, Siemens, Sharp, Coca-Cola, SmithKline Beecham, Hoffman-La Roche, and Sony. There was just one thing wrong with this business district—no business. Nobody seemed to be there. In the middle of a Tuesday afternoon, nothing was going on. We drove up and down empty streets along concrete fences decorated with those international cross-out silhouettes indicating prohibition of this or that: No spitting. No martial arts. No cutting trees. No firecrackers. No breaking the phone.

No breaking the phone? Running beside the roads were miles of conduits with tall arches of pipe at every intersection. These were the water and waste mains. Pudong has been built in a flood plain only a few feet above sea level, on ground too muddy to dig sewers in. This hasn't slowed construction: “The floor space of high rises in Pudong,” said the professor, rolling his eyes slightly, “exceeds New York City.” And there's already a severe real estate glut in Shanghai. Prices fell by 30 percent in the first half of 1997.

A free market is a natural evolution of liberty. But in China, there's a missing link. China doesn't have a Darwinian economy where enterprises can evolve and prosper according to their

ability to survive and grow; China has a creationist economy where prosperity is bestowed by a higher power. Pudong “prosper” by the beneficence of force.

An article in the *Asian Wall Street Journal* last year said this of the government officials in charge of Pudong: “Harking back to their authoritarian instincts...they are deploying every tactic to fill the cavernous neighborhoods they're building.” The article went on to detail how foreign banks are told that they must have headquarters in Pudong if they wish to do business in Chinese currency, and how the International School has been forced to move to Pudong to lure expatriate families into the empty apartment houses.

The Chinese Communists are attempting to build capitalism from the top down, as if the ancient Egyptians had constructed the pyramid of Khufu by saying, “Thutnefer, you hold up this two-ton pointy piece while the rest of the slaves go get a couple million blocks of stone.”

A few months after I took my tour of Pudong, the famous economic crisis developed in Asia. And I had been staring out my bus window right at the cause of it. (Not that I knew it then, of course, or I'd be endowing *The American Enterprise* instead of writing for it.)

Pudong-like nonsense had been going on all over the continent. Instead of money being invested where it could make as much more money as possible, money was invested in strange, showy stuff—thanks to “national industrial policies,” corruption, misplaced local pride, and foolish political reasoning. From Thailand to Japan, bad credit was extended, bad equities were sold, and bad ventures were subsidized—all in hope that success could be gained by some method other than succeeding.

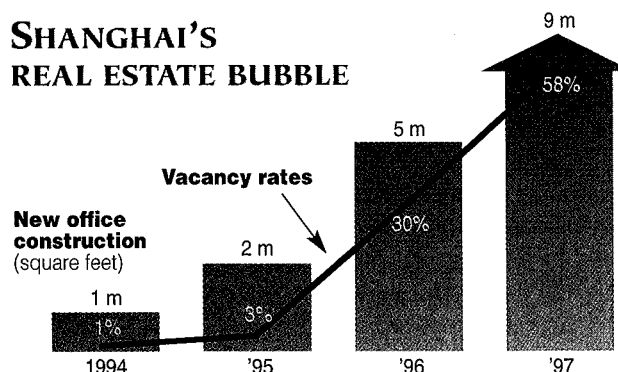
Since Pudong is the worst example of this type of misallocation of capital, the business failures should have started in China. But China has no floating currency to sink, or securities market free to go into free-fall. And the ordinary people of China live in desperate poverty every day of their lives; so when an economic downturn comes they live in—desperate poverty.

Thus China fools us. What has grown fastest in China is not the economy but the credulity of international corporations willing to invest there. Corporations are seduced by the idea of 1.3 billion Chinese customers. Management is fasci-

nated, mesmerized. I worry that, even as I write this, the board of directors at Boeing is sitting around saying, “One-point-three billion! Why, if just one-half of 1 percent of those people bought a 777....”

P. J. O'Rourke is foreign affairs correspondent for Rolling Stone.

SHANGHAI'S REAL ESTATE BUBBLE



Sources: First Pacific Davies China Research; Wall Street Journal.

WHY CHINA WON'T BECOME A SUPERPOWER ANYTIME SOON

BY CHRISTOPHER LINGLE

Despite numerous deficiencies apparent in its current economy, many observers are unrealistically bullish on China's prospects. This *Sinophoria* is built on wishful thinking about the country's economic potential, as well as assumptions that China's recent boom will continue unabated. Very soon, however, China's growth may begin to unravel.

Indeed, China is not even now what some have claimed. After years of meekly re-publishing economic data submitted by Beijing, the World Bank is now looking more closely at China's economic indicators. Although there is no doubt that China has made progress, new estimates suggest that about 30 percent of the population is still living in dire poverty, and that per capita GDP is actually around \$1,800 instead of \$2,500. Even with its vastly larger population, it will be at least three more decades (instead of earlier estimates of about 11 years) before China's economy becomes larger in aggregate than America's—even if no unexpected bumps in the road materialize.

And they probably will. Sustainable growth requires some basic institutional arrangements that are not well formed in China. These include private property rights, protection of individual rights, and freedoms for full development of markets. Given China's Communist legacy, it shouldn't be surprising that there is fundamental misunderstanding within the country on the nature of markets, profits, and entrepreneurs. Although many mainland Chinese exhibit a great affinity with making money, the commercial culture lacks a commitment to mutual fulfillment of contractual obligations.

Some individual Chinese entrepreneurs understand the market, but most government leaders do not. Decades of central planning under Communism have habituated leaders to extensive state intervention in economic affairs. The senior leadership views a vibrant economy as merely a means to a greater political and social end: maintaining political stability in a fractious country. Ultimately, the internal inconsistencies of China's oxymoronic "market socialism" will carry economic penalties.

There are also many short-term obstacles to commerce in China, including heavy bureaucratic interference and a lack of protection under the rule of law. As in too many other countries in East Asia, commercial success now depends on political protection and connections. It would be bad enough if these impediments affected only foreign investors, but they also seriously inhibit home-grown entrepreneurs, the heart of any successful economy.

China is also threatened in the short run by overbuilding. In many of China's largest cities, as in other parts of Southeast Asia, real estate bubbles threaten to burst. At the same time, overheated investments in factories and infrastructure, especially in the Pearl River delta, have created enormous excess industrial capacity.

Amidst these obstacles to business success, China also has a dependent sector that rivals the European "welfare state" in terms of the drag it places on the economy: The country's state-owned enterprises. These make low-quality goods while providing cradle-to-grave services to their millions of employees. Of the nearly 300,000 state-owned enterprises, roughly 75 percent are effectively bankrupt and kept going only by loans from state banks.

Despite much rhetoric about reducing subsidies and forcing these socialized enterprises to sink or swim, there is never clear action, simply because the firms employ many workers whom the government is afraid to disturb. Already, one out of every 12 Chinese citizens is a migrant laborer, many of them unemployed, and 50 million or so new entrants join the labor force each year.

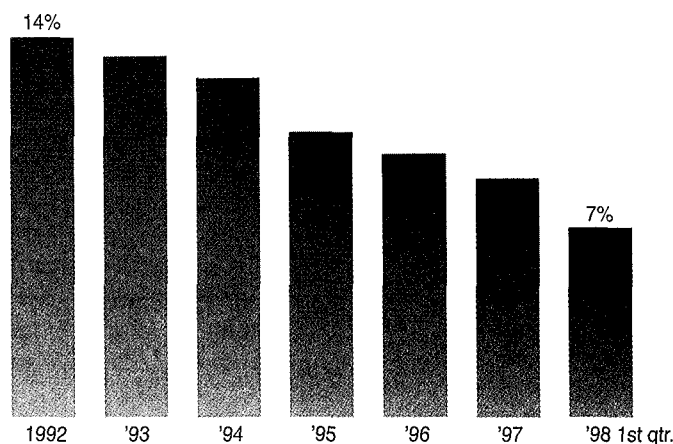
China's current political machinery is also coping weakly with signs of social instability like today's rising rates of crime and endemic corruption. As the Chinese Communist party fails to adapt to the strains of social change, it will gradually lose its mandate to rule.

Even more than other East Asian authoritarian regimes, the Chinese government doles out freedom to its citizens in arbitrary dribs and drabs. As interference from rigid political institutions blocks many of the self-adjusting mechanisms that keep free societies in balance, the country's capacity to grow at high rates in the future will be reduced. China's recent successes should therefore be viewed as short-run outcomes based on an opportunistic political agenda that will limit long-term growth.

In comparing China's current economic balance sheet to other Southeast Asian nations prior to July 1997, it looks like *déjà vu* all over again. The result may be worse in China, though, since its bubble will blow up in the face of over a billion people. Look out for the shock effects of China's "big bust" that could even begin as early as the end of 1998.

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CHINA'S SLOWING ECONOMIC GROWTH



Sources: State Statistical Bureau of China; Wall Street Journal.