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Beijing to Slow Growth

Official Target Lowered in Bid to Fight Inflation, Lessen Dependence on Exports

By BOB DAVIS

BEIJING—China's premier said the government wants slower economic growth to avoid inflation and to restructure the economy, even as much of the developed world is struggling to accelerate expansion.

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Reuters

Customers check prices at a market in Hefei, Anhui province. Premier Wen has promised to tame inflation.

Premier Wen Jiabao said the government's official target for average gross domestic product growth over the next five years will be 7% annually, down from a target of 7.5% in the past half decade. While official targets routinely underestimate growth, the move is nonetheless an important signal that government priorities in the world's No. 2 economy are shifting to reduce dependence on exports and capital-intensive industries in favor of creating conditions for more domestic demand.

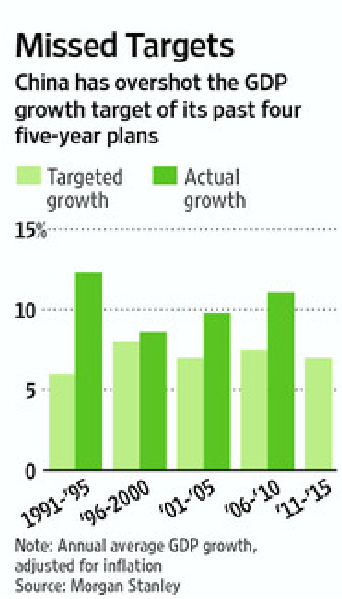
China's stunning rise has come through huge investment in capital-intensive industries like steel and by turning itself into the world's factory floor, manned by workers who migrate to coastal cities from impoverished rural areas. But China's growth rate of more than 9% a year over the past three decades has come with steep costs: heavy pollution, a sharp increase in inequality and pervasive corruption.

"We'll never seek economic growth rate and big size at the price of environment," Mr. Wen told Chinese Internet users in an online chat Sunday in which he disclosed the new target. "That would result in unsustainable growth featuring industrial overcapacity and intensive resource consumption."

Chinese economists cautioned the 7% goal shouldn't be taken literally, but as a signal to the world and to provincial authorities that the government is serious about shifting the drivers of growth toward domestic consumption.

The previous five-year plan, announced in 2006, had a growth target of 7.5%, but the economy grew 11.1% between 2006 and 2010. The last time China set a growth rate as low as 7% was in 2001, when China was recovering from the Asian financial crisis and GDP grew 7.5%. Still, between 2001 and 2005, China's GDP wound up growing, on average, 9.8%, according to J.P. Morgan.

"The official target under the five-year plan tends to be a very poor indicator of growth over next five years," said Qing Wang, a Morgan Stanley China analyst. "But it suggests we'll see slower growth ahead." He forecasts average annual



growth of 9% a year over the coming five years, and less than 8% for the following five years.

Others are less sanguine. Harvard economist Kenneth Rogoff warned China's may stumble more sharply, particularly if it is tripped up by a banking crisis.

A number of economists inside and outside of China argue that the past growth rates are unsustainable, as China's population ages and the country has fewer opportunities for sharp gains by further increasing exports and investment.

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This has lead to a curious dichotomy: The world outside China is trying to accelerate growth to recover from the global financial crisis while China is trying to tap on the brakes.

"Chinese leaders are not averse to growth but they realize they are not getting good-quality growth that has commensurate benefits for the average household," says Brookings Institution economist Eswar Prasad.

Mr. Wen, China's leading economic official, made his comments in the run-up to the formal release of China's next five-year economic plan at the annual meeting of its National People's Congress that starts on March 5.

Mr. Wen every year also issues a separate, and equally symbolic, "target" for that year's growth of 8% in his speech at the start of the legislative session. It is unclear whether that figure will also be adjusted down when Mr. Wen addresses the NPC.

The U.S. and other members of the Group of 20 major economies have been urging China to "rebalance" its growth, so it relies less on export growth, and Mr. Wen has adopted that as a goal since at least 2004. But China has made little progress. The percentage of the economy accounted for by consumption is far lower than in other major economies.

By skewing growth toward investment, the government has funneled the economy's largesse into huge state-owned enterprises and away from households, stoking public resentment. Mr. Wen's call to rebalance growth toward consumption represents a challenge to the state-owned "national champions" who have gobbled up a growing slice of the country's wealth, benefitting their senior managers and their political patrons in the Communist Party. This month, state media reported the sacking of the powerful railways minister who oversaw billions of dollars of investment in state firms building a high-speed rail network.

Provincial officials, who carry out economic plans, also have little incentive to reduce investment because they are largely graded on their ability to deliver fast growth. New projects also can become sources of payoffs from developers and others.

According to the Xinhua report—in a section called "remarkable quotes from Wen's online chats with netizens"—the Chinese government plans to adopt "new evaluation criteria" for local governments that "would give more weight to efficiency, environment protection and the people's living standards." Xinhua didn't report any specifics.

Shifting to domestic sources of demand would invariably mean slower growth rates, said Mr. Prasad, the Brookings economist. But even a slower rate of growth could produce more jobs as labor-intensive service industries develop further. Employment grew in China by just 0.9% a year between 2000 and 2009, despite its rapid GDP expansion.

Premier Wen also made clear that China didn't intend to use exchange rates more aggressively to further its economic goals, as has been urged by G-20 nations. The yuan has appreciated 3.7% against the dollar since China said in mid-June 2010 that it would let its currency float somewhat, for an average of a bit less than 0.5% a month. An appreciating currency can boost living standards by making imports cheaper. It also can be a tool to fight inflation.

The Chinese premier reiterated that the currency would move in a "prudent and gradual manner," according to Xinhua. "A one-off and hefty appreciation of the yuan will bankrupt many export businesses with the loss of workers' jobs, especially those of rural migrant workers," he said.

Mr. Wen was at his most specific in outlining steps that would be taken to limit the rise of property values, which some economists believe are in danger of inflating into a bubble. "We have to contain the excessive price growth and keep housing prices at a reasonable level," he was quoted as saying. The government plans to build 36 million "affordable homes" by 2015, he said, and would use "economic, legal and administrative methods, if necessary, to restrict speculation."

While a Xinhua "backgrounder," discussed China's use of monetary policy to try to curb inflation and property speculation, Mr. Wen didn't mention interest-rate policy in the Xinhua report. Earlier this month, China lifted its benchmark one-year yuan lending rate by 0.25 percentage point to 6.06%, the third rise in four months. More tightening is expected.

But China generally relies on other tools to fight inflation, including industrial policy. To fight food inflation, for instance, China has boosted purchasing price for grains, increased rural water conservation projects and sold government reserves of grain, oil and sugar. It is wary of relying on interest rates, in part, because boosting them makes it even tougher for China to keep its currency from appreciating further.

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