BLACK HOLE 3: CHINA'S JING-SHANG-RE

CHINA was doing something correct: growth rates achieved 13% - and a whopping 20% during the first half of this year in some of the coastal regions. Why, then, are Peking's politicians struggling to prevent the economy slumping into an abyss? They have just decided to freeze prices of government-regulated products and services, as well as the wages of workers in the public sector, in an effort to control inflation that is running at dangerous levels.

Under Deng Xiao-ping, the Politburo decided that communism had to embrace the market. That was in 1978. Capital could be privately owned, and workers could be hired for wages by entrepreneurs. That triggered a growth rate that attracted foreign investment that totalled $9.4bn in the first half of 1993, a 180% rise on the same period in 1992.

All the ingredients for satisfying the pent-up demands of a billion consumers were in place. But there was a flaw in the new system: entrepreneurs could obtain land on leases for rents that were below the market levels. So why bother to invest in the production of wealth, if you could make more money out of speculating in land?

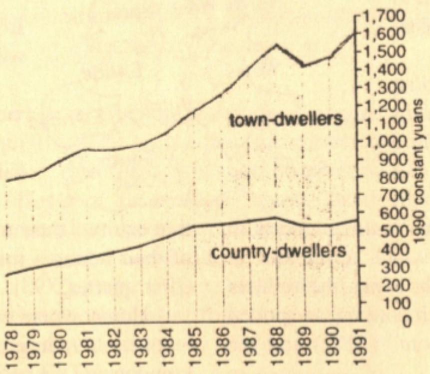
That was a lesson that Party officials were smart enough to learn fast! Even the bureaucracies went into business as real estate developers - to cash in on the rents that Peking could have legitimately charged to cover the costs of spending in the public sector.

The financial sector went wild, participating in an explosive increase in loans to real estate. Banks even established subsidiaries through which they participated directly in the management of real estate brokerages and construction firms. And so, without realising what they were doing, the Chinese had their first taste of *jing-shang-re:* business fever.

The Politburo stepped in to try and smother the speculation. Banks were ordered to cut back on loans to real estate, and over 1,000 special economic development zones have been closed down since August.

A circular from the State Council last August declared that there would be "no approval, no licence, no land and no loans for such expensive projectts as horse race ttracks and golf courses", and the list went on to include villas, luxury apartments, holiday villages and other buildings "with limited market potential". The politicians had realised this activity was attracting the cash that was more urgently needed for roads and railways.

STANDARD OF LIVING
total annual expenditure per inhabitant



Source: *Statistical Annual on China*, 1992

According to China-watcher Satoshi Imai, a senior economist at the Japan External Trade Organization: "Because the economic bubble has diverted money to property acqusition and stock speculation, other major sectors including agriculture and transportation have found it harder to come by the funds they need."

LAND PRICES went into a tailspin. They have fallen by between 20% and 30% from their peak in May.

Too late. Unemployment will now start to rise. Worse than that, however, is the threat of serious political instability, for expectations have been raised to perilous heights. Millions of rural workers, whose living standards lag far behind urban standards (see graph) are migrating to the cities in search of jobs.

Peking has still not fathomed out how economic activity could break so completely loose from its grasp and cause chaos. According to John Wong, director of the Institute of East Asian Political Economy in Singapore: "The Chinese authorities have not published any specific guideline spelling out how a socialist market economy should function. Above all, the exact role and function of government in such an economy has remained unclear and undefined. China's socialist market economy is still operating in an institutional vacuum."

Prof. Wong points an accusing finger at the "rent-seeking activity" of the state's bureaucracy. But he is referring to graft in its various guises (from under-the-counter cash payments, to the extraordinary profits derived from a market that has been rigged against competition). Peking, because of its authoritarianism, can deal swiftly with such graft: for example, eight financial workers were executed on Sept. 27 for their part in a case of corruption.

Not so easy to deal with, however, is the role played by the privatisation of the rent of land. The full market rent had to be paid by the user of land, if productive factors were to be efficiently allocated according to their correct proportions. But we know from 200 years of history that the private pursuit of land-rent has been the major source of economic instability in the modern market economy.

China could have avoided this risk, by reading the warnings of Sun Yat-sen. The Politburo's ideologists failed to do so. Although they have kept the ownership of land in the public sector, the leases were flawed. They allowed a leakage of rent into the private sector - and it was this honey in the pot that caused the *jing-shang-re.*