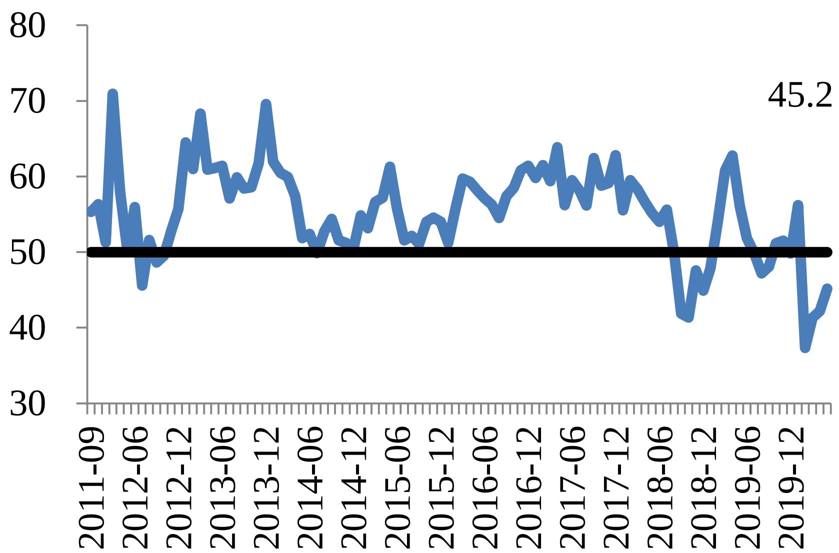
Commentary on the May 2020 CKGSB Business Conditions Index

Professor Li Wei

In May 2020, the CKGSB Business Conditions Index (BCI) rebounded on April's score, rising from 42.2 to 45.2 (Figure 1). It is important to note that China's private economy is still very much in the doldrums, while signs of recovery are emerging.

Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

As the coronavirus epidemic situation stabilizes in China, domestic industry has a chance to get back on its feet. However, with many companies abroad still in the throes of the pandemic and normal operations have ceased, China's diminishing public health crisis makes little difference – industrial chains are stagnant, directly affecting China's import and export business.

If China's economy is to remain weak, this may last for quite a long period of time, because external demand is beyond our control. What will happen next? A V-shaped rebound will be hard to attain, so we need to formulate countermeasures and strategies to deal with a tougher reality. According to the data, perhaps a tick-shaped one, which is a very different scenario to a V-shape. This can be clearly seen in Figures 2 and 3.

Figure 2 **V-Shaped Economic Recovery**

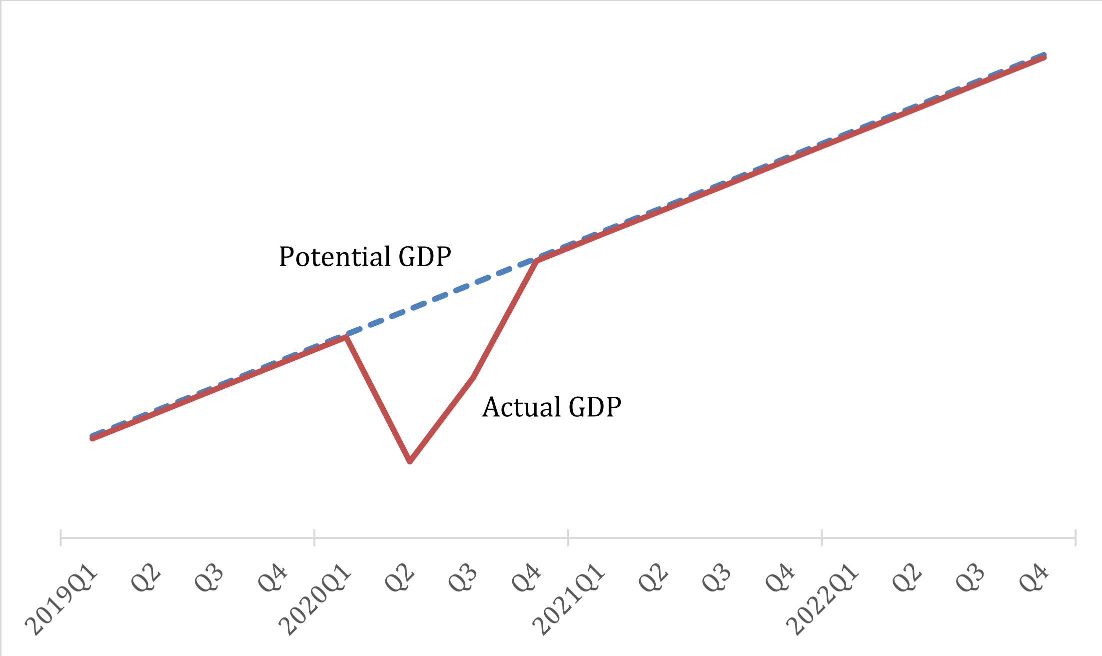
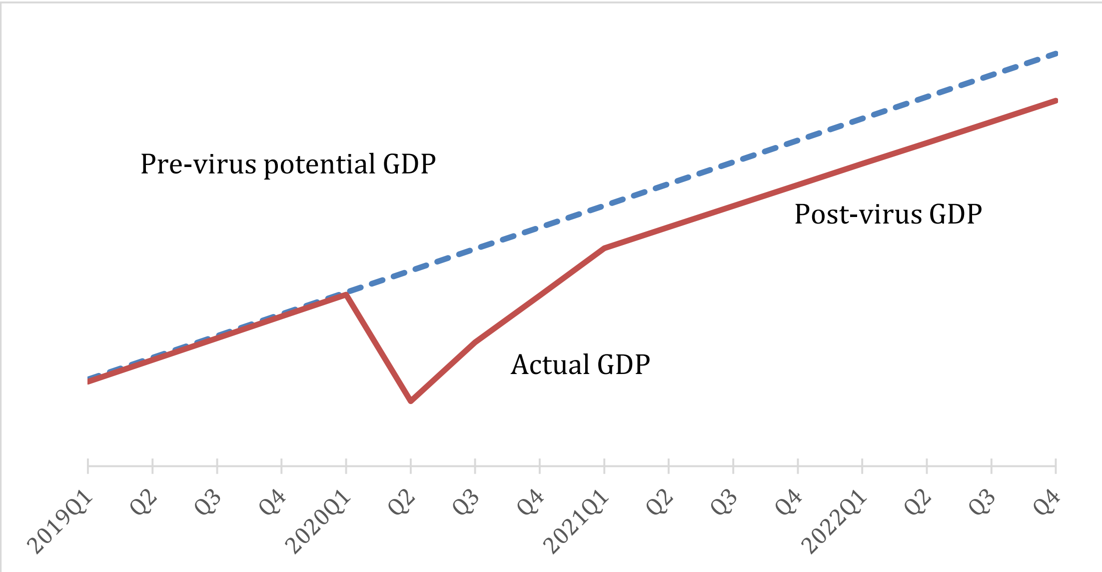


Figure 2 **Tick-Shaped Economic Recovery**



As an economist, a major concern is whether or not China will experience a permanent hit on its long-term potential GDP due to the expected coronavirus recession. This consideration has rarely been applied to China, because the Chinese economy has been developing rapidly since the 1990s, with few periods of negative growth. The situation facing us today is different.

We have seen in the BCI that the index dropped sharply at the beginning of the year, and then rebounded, but with much less force. Meanwhile, the official GDP data for the first quarter of 2020 also showed negative growth for the first time since opening and reform, forty years ago.

This question is an important economic and political issue for other countries too, especially those facing the early stages of economic recession.

An example to bear in mind is the 2008 US financial crisis.

A private US-based think tank called the Economic Policy Institute (EPI), published a report called “Economic Scarring - The Long-term Impacts of the Recession” in September 2009, discussing the four or more dimensions in which such a crisis would impact on long-term growth.

Educational outcomes: Unemployment and loss of income can reduce educational outcomes by cutting into child nutrition, and reducing a family’s ability to provide a supportive learning environment (including healthcare, summer activities, and a stable home), forcing families to postpone or abandon hopes of going to university.

Opportunity: The loss of work and income caused by economic recession will have a lasting impact on people. It will lead to increased poverty, which will have a lasting impact on children and carry long-term economic costs.

Private investment: Total non-domestic investment fell by 20% from its peak level in the second quarter of 2009. This fall in funding means tempering production capacity in the next few years. As new technologies are often used in new equipment, a slowdown in investment may also put the brakes on the adoption of innovations.

The shape of entrepreneurship and business: New and small businesses are often at the forefront of technological progress. With the credit crunch and reduced consumer demand, small businesses are faced with a double whammy. In 2008, 43,500 companies filed for bankruptcy, up from 28,300 in 2007, and more than double the 19,700 in 2006. In 2008, only 21 companies went public with an IPO, much lower than the 163 company average four years ago.

There is plenty of evidence to show that economic outcomes are formed over generations. One’s parents financial woes will feed into the children’s lives. Although it is often said that deficits may cause future generations of taxpayers to transfer wealth to the present, this cost must also be compared with the economic consequences of a recession, which is also passed on to future generations.

According to an IMF article entitled, “The Economic Scars of Crises and Recessions”, in a 2008 paper, a sample of 190 countries indicated that financial and political crisis has a permanent long-term effect on costs. On average, sustained output losses caused by a balance of payments crisis, banking crisis and dual crisis were about 5%, 10% and 15%, respectively.

In addition, according to traditional theory, poor countries have to catch up with the income levels of rich countries, because they should have a higher rate of return per dollar investment. However, historical evidence contradicts this theory, suggesting that in fact, the income of poor countries may fall further behind. The new model explains a key reason for this: poor countries suffer deeper and more frequent recessions and crises, each time suffering the kind of permanent output losses that cause them to lose ground.

Before opening and reform, China’s economy had been in the doldrums for a long time. The economic ups-and-downs has caused serious recession which had led to permanent scars. The reformed economy has shot up, and its economic potential has been better explored. From this perspective, China is now experiencing a major test, so stimulating growth does make sense to a certain extent.

However, while long-term economic weakness or a major crisis may give rise to a permanent setback, we should not act too hastily. The “four trillion” stimulus plan of 2009 was instrumental in bringing about a V-shaped rebound for the country, but in its wake came a series of problems. To this day, it is criticized for having helped develop local financing platforms and swell China’s asset bubble, troubles waiting to ensnare China in the future.

The government has not set an economic growth target for this year, nor did it introduce a major stimulus plan. It merely announced the issuance of one trillion yuan in special national debt, far less than the “four trillion” stimulus plan of the year, and a far less forceful move than developed countries have made. Perhaps China has learned its lesson.

In short, China’s economy is now facing a very serious and complex situation. The trickiest thing of all is deciding how to respond. Our issue is not whether we should save the economy, but how we should go about it. China’s stimulus policies are generally biased towards large enterprises and state-owned enterprises. Private SMEs tend to benefit less. But in reality, private companies employ most people, so this is a misjudged action from the perspective of job security. Our BCI survey shows that SMEs are the most dynamic group in the Chinese economy, but this group is vulnerable in terms of preferential policies and financing. This is not only one of the most obvious structural problems in China, but also a worldwide problem. When China solves this problem, it will begin to grow again.

This is a commentary on the CKGSB BCI report for May 2020. Do not hesitate to contact the BCI team by email as shown in the accompanying BCI data report.

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