



China Will Grow Enough!

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University

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It is a pleasure to be invited to Columbia University 2012 China Forum. Professor Xiaobo has prepared questions for the Panelists. Here are my responses. But first a prefatory remark: I am a practical business marketer, not an academic economist. I see China on the ground, and I am optimistic about its future for good practical reasons, as you will see in my remarks below.

Kotler Marketing China has been operating successfully for 13 years in China working with Chinese SOEs, private companies and local governments. See www.kotler.com.cn; also read our new book *Market Your Way to Growth*, by Philip and Milton Kotler (2013, Wiley) and visit our Kotler on Growth website: www.kotlerongrowth.com

Professor Xiaobo's Questions

1. What do you see as the most challenging economic problems China will face in short and long term?

- A. The long term is the result of the serial outcome of short term political, business and social decisions, - adjusted by destiny, fate, and accident. Because policy is

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directed by politics, it is always short term, either to get re-elected if you are in a democratic society, or to avoid social disruption if you are in a one party society.

Long term strategies and prognoses are intellectual concepts that may influence short term decision. I can only talk about what can might or should be done to improve things in the here and now, and what shortly follows.

- B. The three pillars of growth are consumption, investment and trade.
1. Consumption is growing at 9.88% as last reported for 2011. This has to rise at a higher rate of 13% - 25% annually to reach 50% of GDP, in order to make up for the declining growth rate of export trade. Rising consumption requires: 1) Urbanization, which is the greatest driver of economic growth, has to increase 2 million more urban people a month to reach its target of 350 million more urban population by 2025. Urban households make more and spend more than rural households; 2) Reform of Hukou system to develop the productive value of urban migrant urban workers and professionals; 3) Health care to relax savings; 4) Increase in the minimum wage for more spending; and 5) Propaganda and facilitation of increased consumer credit.
 2. Investment: 1) Rapid development of new urban clusters for greater cost, earnings and life style efficiencies (Megacities are becoming inutile); 2) Available housing supply has to be ready and waiting to relocate rural people for rapid industrial and commercial land redevelopment (that is a major reason why there are empty residential towers waiting for these people); 3) Transition shadow banking, which represents 40% of China's capita, into a modern municipal bond market to support an estimated need for \$6 trillion for urban infrastructure in 12th 5 year plan; 3) more ODI for New Market resources and sales in Africa, Latin America, SE Asia, South Asia, ME, and Eastern Europe; and for technology acquisition from developed economies for value-added domestic production for both domestic consumption and export.
 3. Trade: 1) Intensification of trade in emerging markets, e.g. Africa, Latin America, South Asia, SE Asia; 2) Chinese branding in developed markets for higher premium value of improved B2B and B2C equipment, goods and services.

2. Does the slow-down in growth rate indicate China has passed the take-off stage of development and entered a new era of slower growth? What are the implications of this?

Extended global economic decline and stagnation will reduce China's rate of GDP growth to 6%-7%. Michael Pettis (his book *The Great Rebalancing* is a must read!) predicts 3-4% GDP levels. This will reduce the government's investment drain on savings interest and, along with wage increase, will create more disposable income for consumption. From there on, the rate of consumption will grow by disposable income and consumer debt and reach global norms

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within the world benchmark range of 50% to 70%, leaving behind today's extraordinary high savings rate. Increased consumption will mitigate manufacture decline, but probably will increase unemployment to manageable levels. Other elements, like greater welfare and health benefits and greater openness to foreign investment, will have to enter the new development phase.

3. China is alarmed by the inflationary pressure generated by the sustained loose monetary policy in the US and EU. Should it be?

A. The loose money policies of U.S. and EU are attempting unsuccessfully to reflate their economies and reduce unemployment. In fact, we are in a devaluation period and the loose money is helping the banks and corporations to deleverage on the back of depositors. Consumers are also deleveraging with cheap money for refinancing and household debt reduction.

This is happening all over the world, even in China. There is little consumer demand in developed economies to support profitable investment. We are in a period called "the death of demand." At some point monetary easing will have to end. Balance sheet cannot carry infinite debt. When money tightens, interest rates rise, but so do prices. If consumers decide to withhold their higher interest savings dividend from the marketplace, then we enter the familiar period of stagflation and continued high unemployment.

Inflation will worsen China's trade because of the great spike in necessary commodity import costs. Chinese consumer prices will spike with higher import costs of food and energy. There is reason to be alarmed; but government action can mitigate severe effects.

B. Finally, let me say that I think the U.S. should be more alarmed than China, because the West has less demographic market growth potential.

4. Last year at this forum, there was a debate about the aging population, rise of labor costs, and shrinking of skilled labor pool. What's your view on this? Do you see China has entered a new phase of economic growth model where labor-intensive, manufacturing industries may lose their comparative advantage?

A. There are two issues here: 1) should China change from one export development model to another export development model? And 2) should China move from export development to domestic consumption?

The historic export development model has been low price, low value export of consumables and durables. Remember there is a great growing emerging country market and substantial segments in the developed country market that still need and want junk. Some of this production is moving elsewhere; but China's supply chain market is not available elsewhere. China will continue its low end consumer goods export for a long time to come because there is a big poor world out there

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without a supply chain. As developed economies stagnate, there are growing low income segments that shop at Dollar stores and discount appliance outlets. Safe, cheap China cars are next.

- B. China has been shifting to value-added production for a decade. I have been there and I have seen it and helped it. World markets - emerging, developing and developed are beginning to buy China's improved machinery and equipment, as well as its consumer brands. With more ODI investment in technology and brand acquisition this mid-value export will grow.
- C. China is trying to grow its domestic consumption market. As difficult as this is, she will succeed as wages and urbanization proceed. So the answer is a mixed model of junk and good stuff for export and junk, value and good stuff for domestic consumption. We will leave luxury to Europe.

5. Debts are very much in policymakers' minds these days. The Chinese are no exception. How bad is China's debt problem as you see it? Is China in a better or worse position to tackle it?

- A. The world is awash in debt. China prints and controls its currency. The U.S. prints and controls its currency. The real losers on national debt management are the EU members, with the exception of Germany, who don't have the own currencies to manipulate. But since Germany has to bail everyone out, she is in trouble with their debt and likely to bail out.
- B. China has many ways to handle its debt. As the RMB moves closer to a world reserve currency, she will have even better ways to handle her debt. I think the U.S. and EU debt problem is worse in terms of the declining standards of living and resulting social unrest. They have farther to fall than China, and no high saving rate to cushion decline.

6. Some economists suggest that the real estate bubble and over-capacity are two acute problems China faces in short term. Do you agree?

- A. There is a real estate glut because Chinese private capital wealth has few options for investment return. But a glut is not a bubble because of urbanization and middle class growth will absorb this supply. If the pace of urbanization continues as planned the so-called bubble will resolve itself.
- B. People are always talking about empty residential towers in China. What they do not realize is that these new apartments have to be ready to absorb relocated rural people, who have, willingly or unwillingly, exchanged agricultural land for urban life. They need a quick place to move to, so the industrial and urban redevelopment of their land can be quickly developed.

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7. The new leadership seems to intend to liberalize some sectors preciously monopolized by the state. How hopeful are you in this regard? What sector do you think are the most promising (for private investment)?

- A. Chinese banks cannot support SOE monopolization forever. Investment supply must reach into private Chinese company capital reserves, private wealth sequestered in shadow banking, and foreign investment. Every sector will open up to privatization. Investment need exceeds Chinese bank capital supply.
- B. China's seven Strategic Enterprise Industries (SEIs – biotechnology, new energy, high-end equipment manufacturing, energy conservation and environmental protection, clean energy vehicles, new materials and next generation IT) are good sectors for private investment, because the SOEs will need a host of new private suppliers of goods and services.
- C. Don't forget the Western development of China, and the great entrepreneurial opportunities of a new frontier.

8. Lagging domestic consumption is widely regarded as one of the key weaknesses of the Chinese economic development model. Even policymakers realize that. But what would you do to change the situation and spur domestic consumption?

- A. I have advocated advancement of consumer credit for a decade in China. This is the way every developed country has expanded consumption. Great progress has been made in this direction. China is now the world's single largest credit and debit card market by number of cards. But the Chinese use their credit cards sparingly. The government has to promote great use on consumer credit. Union Pay is no longer alone. Visa and Master Card are playing a growing role the consumer credit market.
- B. It is a psychological fact, born out by Western experience that people are more ready to spend money they do not have for things that they want now, than spend money they do have for things that they want now. Buy now, pay later!

9 That Chinese economic structure-relying on investment, export, and domestic consumption-- is in urgent need of change and reordering is a consensus. The challenge is how to rebalance and restructuring in the time of crisis or in the wake of crisis which exerts pressure for making growth a priority. Forget about the Chinese cliché that a crisis means both risk and opportunity. The reality is that crisis often makes restructuring that much more urgent yet also makes it much harder to restructure at the same time. So how do you do it?

- A. First, I question the assertion that China is in a crisis, unless the term is used loosely. Chinese unemployment barely scratches the surface of U.S. and peripheral EU unemployment. I would say that Spain is in a crisis with 27 % unemployment...same or thereabouts for Greece, Portugal, and Italy. The politically consequential social unrest of peripheral EU unemployment is greater

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- than the social political unrest of China. The U.S. has its share of unrest with an effective 16% unemployment. China may have more protest, but it is a bigger country and these protests are less politically consequential than elsewhere.
- B. The twelfth 5 year plan of China is a strategic path of growth that China can manage, given that the rest of the world can manage their greater crises. The whole world is interconnected, but China is not at the cutting edge of crisis.

10. The new Premier, Li Ke Qiang, said at a recent meeting that after three decades of reforms, the dividends of many of the reforms have run out. New reforms must be implemented so that China can find new source of dividend to continue the growth. If you were at that meeting with him, and was asked to offer two or three reform measures, what would you advise him?

- A. Open China to more in-bound foreign investment. The magnitude of vast and rapid urbanization into a structured industrial and supply management system is the fundamental premise of global investor confidence in China.
- B. Open China's capital market to global financial institutions, so Chinese industry becomes more competitive and efficient.
- C. Continue the policy drive to making the RMB convertible and a world reserve currency.
- D. Go slow on political reform. Too much needed capital is tied to the existing system. Political reform causes its own unrest, and unnerves capital sources.