QUOTE OF THE DAY
If you do not change direction, you may end up where you are heading.
– Lao Tzu, ancient Chinese philosopher

Asia needs reforms, not miracles, to escape the middle-income trap

BUSINESS ANALYSIS

George Magnus

IF CHINA'S growth permanently slows in the coming years, as George Magnus anticipated in Part I of this series, Chinese foreign investment and trade is likely to decline somewhat as well. What will happen to other developing Asian economies as China pulls back on trade and direct investments in the region? What political and economic reforms must be made to cushion the transition?

What follows is Part II of our three-part series on China's economic outlook and its impact on the world:

THE SLOWDOWN in China's sustainable growth rate may be only half-completed. From growth of between 7.5 percent and 8 percent currently, it will most likely decelerate further to between 4 percent and 5 percent over the coming decade.

As this happens, and as the commodity intensity of China's growth model declines, there will be profound implications for commodity producers. This also applies to the complex manufacturing supply chains that run throughout Asia.

But growth in emerging Asia is already slowing down. This corroborates the view that if there was anything miraculous about Asia's economic performance from the 1990s to the 2000s it is now history. How should we assess Asia's prospects now?

In spite of the financial crisis in Asia in the late 1990s, growth in developing Asia recovered strongly, reaching a peak of over 11 percent in 2007. Subsequently, it has slipped to between 6 percent and 7 percent. That is roughly where it was for much of the 1990s.

Asia, excluding China, has now returned to growth of about 5.5 percent. The International Monetary Fund (IMF) predicts more or less stable growth around this level for the next several years.

However, in my view, there are six reasons why Asia will have to look to reform, rather than miracles:

1. China's own economic performance may be less robust than is widely assumed.

If China's investment share in gross domestic product (GDP) slides back to "only" 40 percent by 2020 from the current 50 percent share, this will have very direct consequences for the rest of Asia.

The cost to growth, according to the IMF, could be between 1 percent and 2 percent of GDP in the Philippines and Indonesia, between 4 percent and 6 percent of GDP in Malaysia, South Korea and Thailand, and 10 percent in Taiwan. Inevitably, there would be additional multiplier and spillover effects.

2. The export-centric models of countries belonging to the Association of South-East Asian Nations (Asean) and, to a degree, of larger nations, such as China, South Korea and Taiwan, have become flawed in the wake of the Western financial crisis. Prominent Asean members include Indonesia, Malaysia, Thailand, Vietnam and the Philippines.

It is often suggested that South-South trade, or trade between developing countries, will substitute for weaker trade with the West. But even though developing countries now buy more than half of one another's exports, a lot of this trade is with China, is commodity-related and is the product of deeper supply chains.

Residential buildings under construction at Tianjin eco-city in China. As the largest Asian economy starts to decelerate, other countries in the region can no longer rely on China for a stimulus, and already their growth has fallen back to where it was for much of the 1990s. The next boost will come from internal reforms, argues the writer. PHOTO: BLOOMBERG

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According to the Asian Development Bank, roughly three-quarters of Asian exports end up outside the region, predominantly in Europe and the US.

3. Asia's financial indicators are flashing warning signs, even if there does not appear to be any immediate threat of instability. Excluding China, the ratio of credit to GDP has risen above 100 percent – higher than it was in 1997. Also, land loan to deposit ratios in Asian banking systems are rising significantly again.

4. Asian countries, including China, are now richer and more complex. Their prospects will depend more on total factor productivity, or the immeasurable phenomenon that boosts GDP through technological and organisational efficiencies, and through the effects of robust institutions.

Total factor productivity rose to nearly 2.5 percent in the 2000s but has since slowed. To strengthen it, Asian governments will need to spur innovation and other new ways of replicating the benefits of the past decade or so, when growth was achieved by educational attainments, electrical power consumption, air transport, telecommunications and internet usage, and higher value-added exports.

5. What about India? Asia's soon-to-be most populous nation has yet to harvest its so-called demographic dividend. India's working age population is predicted to grow by 350 million by 2050. That increase is larger than the stock of working-age people in western Europe today.

But, as things stand, India isn't going to be a game-changer for Asia. After a short-lived 10 percent growth burst in 2010 and 2011, India's growth has halved.

The demographic dividend will accrue only if India can raise its game significantly on job creation. That is a big challenge given that about a quarter of all people deemed to be employed are also deemed to be at or below the poverty line.

This is a failure of labour market governance. There are other failures, notably with regard to India's construction programmes and adequate infrastructure, as well as export growth and diversity.

There are also the twin deficits, with external and public budget deficits of between 9 percent and 10 percent of GDP. These important economic deficiencies can be remedied only by significant political and institutional reforms. Moreover, India's fragility is attributable in large measure to the degradation of state institutions.

6. Not only is income inequality rising in Asia, but it is constraining growth.

Low levels of income inequality empower a broader society, which keeps the political system open. Both are considered important characteristics of sustainable, inclusive growth.

Extremes of inequality are widespread in Asia, and in most cases they are at levels higher than in any of the countries that have succeeded over the past 50 years in graduating out of the middle-income group to the high-income universe.

It has been argued that Asia's miracle occurred because Asians came to understand, absorb and implement Western best practices – free market economics, modern science and technology, meritocracy and the rule of law. For some countries, more or less, this assertion is unquestionably true, complementing vigorous resource mobilisation. But the latter has now been exploited or is more difficult. In addition, Asians face a less benign global trade and economic environment, as well as heightened economic and political security risks.

Without strong reform initiatives to sustain high domestic growth, many Asian miracle countries could get stuck in a middle-income trap.

George Magnus is an independent economist and an adviser to UBS and other investment banks. This is the second of a three-part series. Read Part III next week. This article is provided as a courtesy by The Globalist (www.theglobalist.com), the daily online magazine on the global economy, politics and culture.

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Welfare capitalism could be a win-win situation

BLACK JACK

Vuyo Jack

MAY IS Worker's Month and provides good time to reflect on the value of having workers. What I have realised is that there is no business that does not rely on human resources to operate. The question really revolves around how many people are needed. Over the different eras of our civilisation the value of workers has never been fully appreciated. In the tribal era everyone worked for the community, but then the idea of having slaves was prevalent as a result of tribal wars. The losers of the war were absorbed into other tribes while other people were made slaves to serve the victors.

There was also a stage where Theocracy took over and the religious rulers were in charge of the affairs of religion and state.

The people served the church by paying tithes and their rewards would come in the hereafter. They also paid taxes to the state which were sometimes used to finance holy wars. This was aptly called the dark ages. The aristocracy overtook theocracy when land ownership came into the equation. The different classes were created based on various factors such as being born into nobility. The caste system in India is one great example of arbitrarily segmenting people into different classes based on the class status of their parents. Under the aristocratic era the rights of workers was non-existent and abuse of power classes was rife.

The French Revolution saw the dawn of the democratic era when the French aristocracy was toppled and the government by the people for the people now known as democracy was introduced, around the same time the principles of capitalism were formulated by the likes of Adam Smith. The democratic era provided a context for the Industrial Revolution, where creativity was unleashed in abundance but the plight of the workers did not improve dramatically. In essence the workers had to work everyday for a small wage. The industrial revolution saw the productivity being sucked out of the workers even to the point of using children in the factory. The bottom line is that people who benefited from the Industrial Revolution were the industrialists who grew richer while the poor languished in poverty. The factories were not safe and lots of injuries occurred, resulting in child-headed households.

With the advent of communism, the plight of the workers improved as the theories of Karl Marx were applied in Russia to fuel what became known as the Russian Revolution. The communist manifesto gave voice to the workers and accelerated the fall of the aristocracy further, while at the same time allowing democracy to rise in some countries. I now see the importance of the communist manifesto in the workers movement.

The point of this analysis is to show how hard workers have had it over the last few centuries. It is only in the 20th century that the conditions of the workers started improving, using democratic means to pass laws that solidified the rights of workers. The communist principles have made

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the workers strong in their resolve and crisp in their arguments when giving input in policy setting engagements.

It is also interesting to note the debate about the impact of welfare capitalism practiced by innovators such as Henry Ford. Apparently Henry Ford doubled the minimum wages of his workers in order to motivate them to increase their productivity. Later Ford is credited with inadvertently creating the weekend as we know it by giving his employees Saturday and Sunday off. He was heavily criticised by his peers for increasing the cost of employment in the auto industry.

However, he started seeing the impact of such measures on the increased productivity and consequently the profitability of his company. Ultimately, he believed that having employees who were well rested and well paid was the key factor to the company's success. This breed of capitalism had a win-win effect.

The unions have emerged over the years as the protector of workers' rights. Their focus was to make sure that the conditions of work that workers found themselves in improved along with their pay. It is interesting to see this in action in Germany where the unions think symbiotically about the interest of workers as well as the sustainability of business. They are willing to take wage cuts and negotiate conditions that will result in favourable result with the employers. This culture is based on trust capital that exists between the unions and employers.

So, welfare capitalism might not be a bad idea in South Africa where the worker and the employer have a win-win relationship with great impact on society.

Licensing of business bill is a serious overture

CONTROL OF BUSINESSES

Denis Worrall

FEW PIECES of legislation have drawn such fire as Minister of Trade and Industry Rob Davies's Licensing of Businesses Bill – and with good reason. Contrary to some commentators' view that it is a "useless" piece of legislation, it demands to be taken very seriously indeed.

For the benefit of our international readers we should explain that the bill requires the licensing of every business – yes, every business – in South Africa by the municipality in which it is based.

The size and nature of the business does not matter, and the licensing process will obviously involve a massive increase in bureaucracy.

In a recent newspaper article, Free Market Foundation chief executive Leon Louw described the consequences: "Nothing, absolutely nothing, will escape the clutches of the bureaucracy which the bill will require.

"The country will be deluged by wall-to-wall apartheid-style bureaucrats, who will control everyone who supplies anything, from the little old lady selling corn cobs under a tree, to foreign multinationals, from subsistence farmers with their donkey carts, to escort agencies, from part-time ballet teachers, to alternative theatre."

To illustrate Leon's point, the bill (and specifically section 25) even provides for hawkers, who could face extraordinary penalties for seeking to ply their trade. Under the bill, any person who carries on business as a hawker without a valid licence will be guilty of an offence and liable to a fine of an unspecified amount or imprisonment for up to 10 years or both.

According to Lawrence Mavundla, the outgoing president of the National African Federated Chamber of Commerce and Industry (Nafcoc), the bill will take informal traders back to the worst days of apartheid when "government bureaucrats had the power to inspect the books, search the premises, shake down the owners and shut up the shops of so-called undesirable elements".

For a thoroughly competent dissection of the proposed law – the ministerial intentions, the scope, the power and the damage it will cause – you could not do better than visit Anthea Jeffery's analysis on the South African Institute of Race Relations website (www.sairr.org.za).

Some idea of this legislation's sweeping authority is expressed in section 42, which provides that: "Every municipality will be empowered (in consultation with the Minister of Trade and Industry, the Minister of Local Government and the relevant member of the executive council) to make by-laws regarding licensing of businesses in any substantive or procedural matters connected therewith".

In other words, any number of onerous requirements could be added under the authority of this blanket provision and the justification for this bill.

What is the Department of Trade and Industry's rationale for this legislation? "The licensing of businesses is intended to promote the right to freedom of trade, occupation and profession." It is also supposed to "encourage a conducive environment that promotes compliance and sustainability of businesses".

These might be the intentions behind the bill, but in practice the proposed measure is sure to have the opposite effects, a point publicly made by at least a dozen commentators and editorial writers.

Aside from the purely practical aspects (the fact that many municipalities are notoriously inefficient and incompetent), this added red tape inhibits the emergence of small businesses and entrepreneurship – growth areas where South Africa already lags behind other similar countries – and restricts informal business, a major source of employment.

The department also claims that it is important for each municipality to "know who is conducting business within its area of jurisdiction, so that it can curb the illegal ones that often sell dangerous and hazardous or counterfeit goods".

As the Institute of Race Relations points out, the selling of dangerous or counterfeit goods is already prohibited by other laws. In addition, it remains uncertain what benefit, if any, municipalities will derive by demanding details of local business operations in the way the bill requires.

The reasons offered for this bill simply do not add up. The costs in terms of red tape and the cursory rationale become intelligible only if an ideological element is injected: the state's determination to control all business in this country.

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