



# CHINA AT A COMPETITIVENESS CROSSROADS

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As the economic crisis has engulfed the world, China may be the country that leads the rest of us out of our current morose state and drive future growth. China is now at a crossroads. Will the country seize this opportunity to push through important reforms?

China's competitiveness, as measured by IMD's World Competitiveness Yearbook (WCY), has surged up through the rankings, surpassing all precedents. First covered in 1995, the nation ranked in 34<sup>th</sup> position out of 41 economies, alongside the likes of Indonesia, the Philippines and Colombia. China moved into the top 20 in 2006 and has since maintained a ranking between 15<sup>th</sup> and 20 out of an average of 55 nations. Only nimble Ireland has moved up the competitiveness ladder as quickly. Contrary to China, Ireland has not been able to maintain its strong ranking.

Will China choose a path towards an advanced development phase, converging with more mature and prosperous countries (and improved competitiveness) or will it choose the status quo? If it opts for the former, it could turn the consequences of today's global crisis into golden opportunities and deliver more sustainable growth over years to come. But China could just as easily and probably more comfortably, rest on the laurels of its past success. This implies that it would fall back on the past drivers of growth, mainly exports and investment, which were responsible for generating close to 10 percent growth rates over the past three decades. This is unsustainable.

Crises promote companies that invest in innovation and new technologies, increased productivity and human capital. They create opportunities to restructure and to focus on core activities. Governments must do the same! Will the Chinese government seize the opportunities arising from this crisis to implement and commit to reforms?

## **A new conundrum for China**

The current optimism for China arises from the high expectations of the impact of the government's \$586 billion economic stimulus package. Destined primarily for upgrading infrastructure and stimulating employment, the new spending is accompanied by loan expansion to counter the effects of the credit squeeze and, but less advertised, is supported by the incredible resilience of the Chinese people.

The stimulus package, representing nearly 15% of China's annual economic output spread out to 2010, should help offset the slowdown in growth from falling exports. A large component

targets increased investment to deliver a rapid shot of adrenaline to the economy – a choice in the direction of the status quo. Other hand-outs aim for more structural changes and reforms to move the country away from its dependency on exports and investment, such as encouraging private small and medium-sized companies and targeting services. But the benefits would take longer to materialize, with fewer immediate repercussions on growth.

As headlines boast more “green shoots” in the Chinese economy, the nation is showing signs of being one of the first countries to rebound. But from the Chinese perspective, its growth, even if above the expected eight percent (a psychological landmark), will not be sufficient to lead the world out of recession. At a per capita GDP of around \$3,300 and only accounting for a little over seven percent of total world GDP, one should not over-estimate China’s role.

## Opportunities

The frontiers of China’s business landscape are changing and we are moving into a new world. Will companies rise to the challenge to reap the benefits of a new playing field?

China’s stimulus package will have more “bang for the buck” than in the developed world, with people spending most of the money they get. Contrary to industrialized countries, individuals in emerging nations are “first-buy” consumers: the first car, first vacation, first home.

To encourage spending in China, the government is even subsidizing a wide range of consumer goods. New fiscal policies comprise transfers to farmers and low-income households in urban areas to put more money in their pockets. Nonetheless, it’s too soon to see a reversal in trends: the Americans saving more and the Chinese consuming more, but some re-balancing is bound to happen. Some companies may see the writing on the wall and become “early-movers” in the market.

The rise of the middle-class in China and increasing urbanization will create substantial new markets. McKinsey estimates that 350 million people will be added to China’s urban population by 2025. Businesses can leverage this growing middle class, offering a greater choice in consumer goods and accessible luxury items.

This doesn’t stop at the factory. The skills and talent gap in China represent challenges to educational suppliers worldwide. The shortage of competent managers and their lack of international experience (ranking last in 57<sup>th</sup> place in the WCY) are huge operational problems

for multinationals and locally-owned companies. Consequently, management schools and training institutes that can help Chinese managers acquire more leadership qualifications and develop soft skills will be increasingly in demand.

Infrastructure projects will be the big winners from the \$586 billion stimulus. Labor and property costs are still very low and consumers are hungry for greater access to consumer goods and entertainment, especially in the fast-growing western provinces. The construction of shopping malls, cinemas, recreational facilities, etc. will tempt locals to loosen their wallets, most often on a “first-buy” basis. Many farmers are quickly turning into avid consumers.

But China will also have to manage the negative externalities: congestion, bottlenecks, pollution and social disruption that are inevitable with such “bulldozer growth”. The country will witness spiraling demand for energy and natural resources, and the rising challenge of providing social services for the growing urban population. Foreign companies could increasingly share their knowledge gleaned from successful urban planning in European capitals, environmentally-friendly green technology, energy efficiency and communications and transportation networks.

## **Which path will China take?**

One cannot ignore that continued strong economic growth in China will fuel the appetite for Western products and lifestyles – but with Chinese characteristics. This means that foreign companies need to take into consideration Chinese values and differences. The “Western Capitalist” model has shown its weaknesses with the global economic crisis. Chinese leaders now wish to prove that there are alternatives and are re-writing the rules of the game.

In this scenario, choosing the path of long-term sustainable growth, China has to invest in the business, economic and social structures which characterize a more mature and advanced economy. The country has to move away from the bumpy road of exuberant economic growth to the more stable and sustainable path which leads to long-term prosperity. Looking back a few years from now, this will surely prove to be a wise investment into a more harmonious society and ensure China’s future competitiveness.

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