



China's Evolving Growth Model: The Foshan Story

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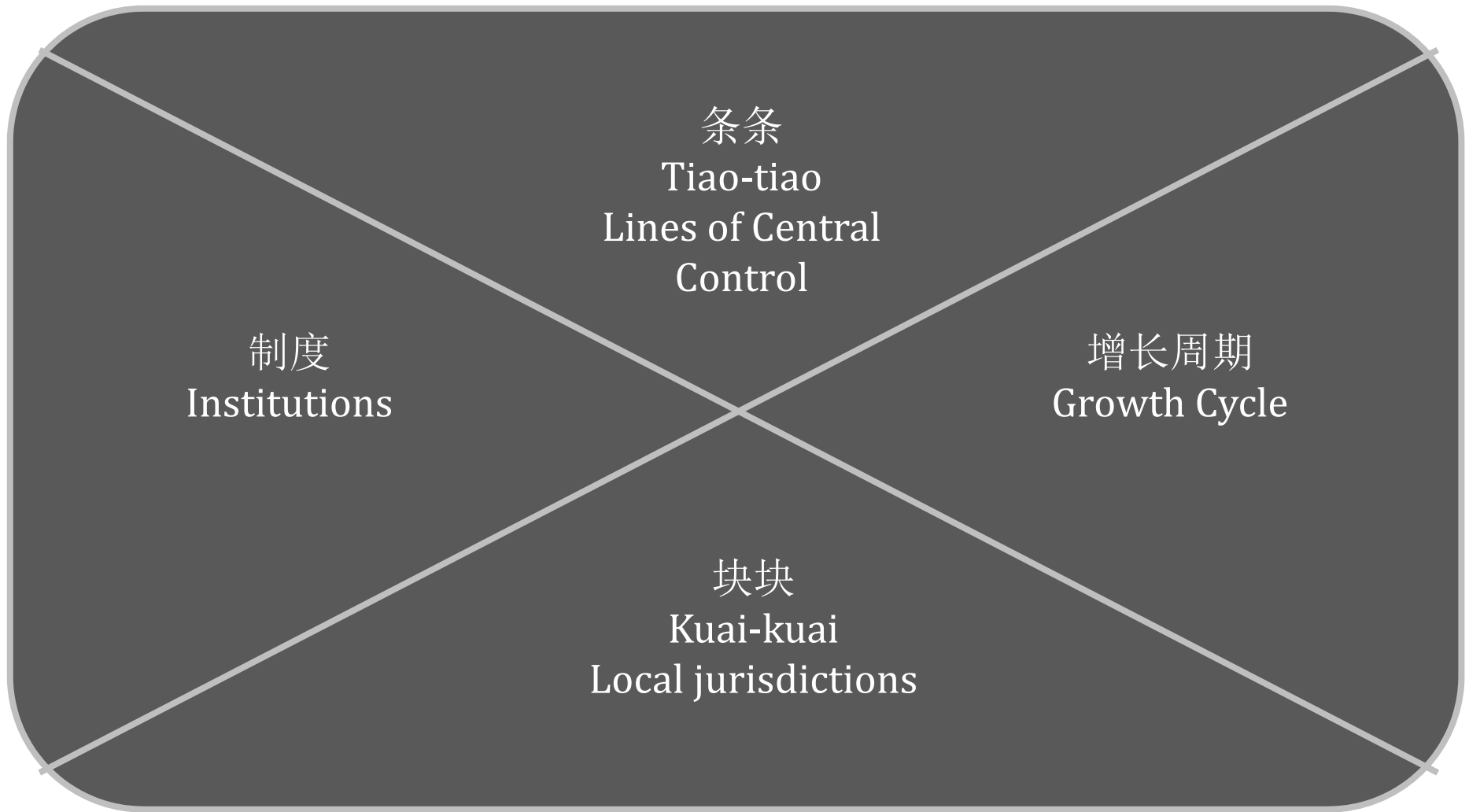
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China's Governance Matrix



**Institutions for enabling both state and market:
two sides of the same coin**

Property Rights Infrastructure

State quality determines institutional quality which
determines market quality

Rights creation:

Rules for delineating rights and responsibilities, especially property rights

Exchange facilitation:

Platforms for interactions among market participants, especially for exchanging property rights

Dispute resolution:

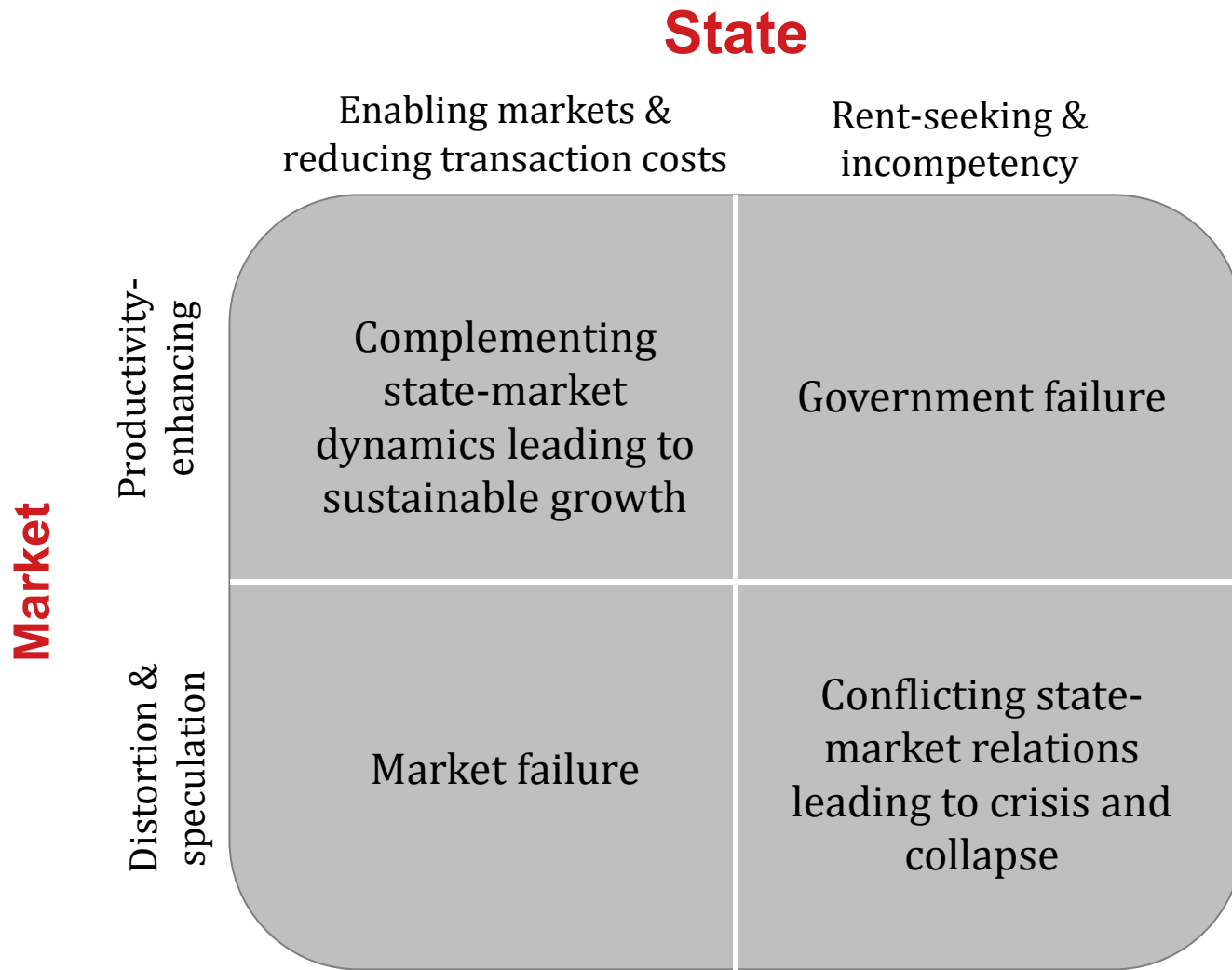
Processes for resolving disputes, fine-tuning and enforcing property rights

Foshan's increasing competitiveness: declining transaction costs

- What are transaction costs?
 - Costs of inadequate institutions and incentives
 - Any human-made costs that hinders mutually beneficial trade
- $\text{Competitiveness} = 1 / (\text{Transaction Costs} + \text{Factor Costs})$

China is becoming more competitive because of reforms that bring the benefits of both the state and markets!

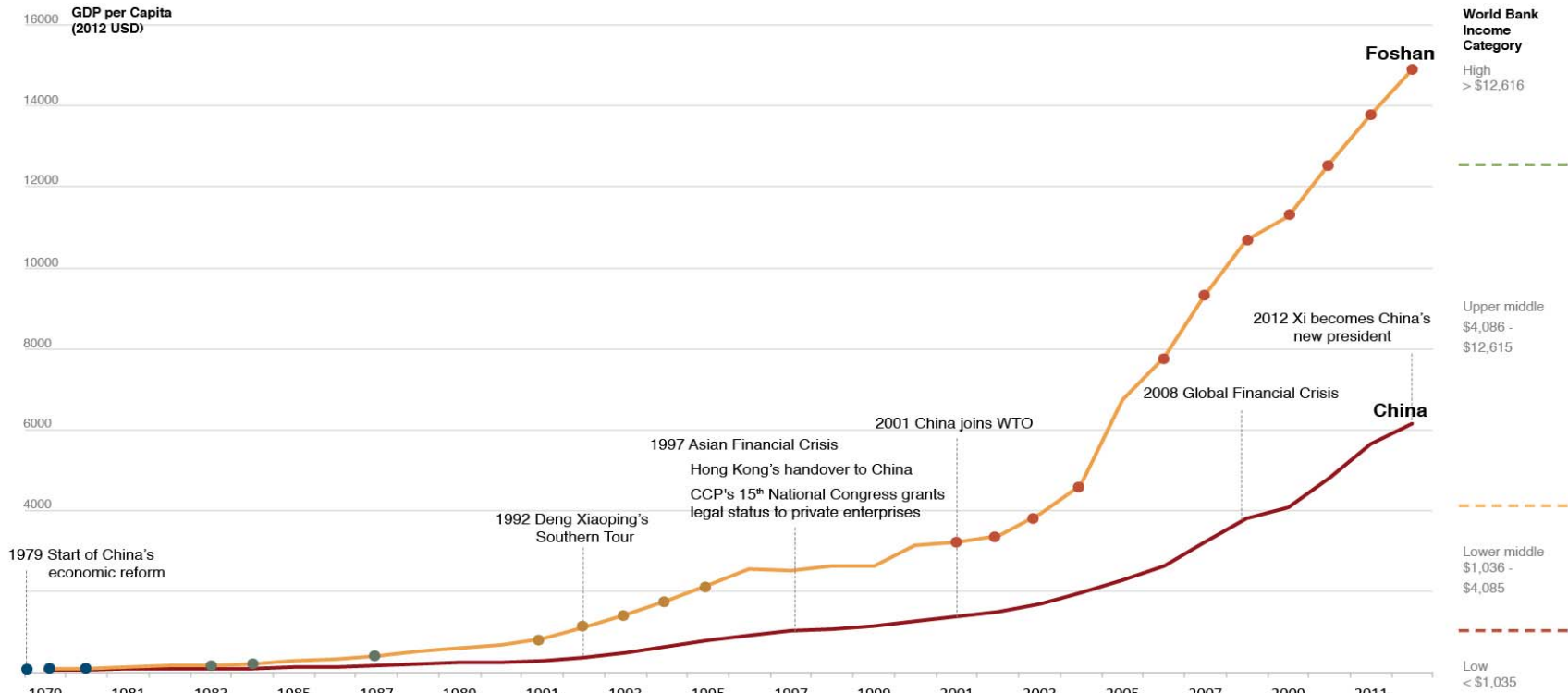
State-market dynamics: fragile or anti-fragile?



The 1st Surprise: outstanding economic performance

- **Productivity:** The city's *per capita* GDP reached US\$14,828 in 2012 – higher than Shanghai or Beijing, and well within the World Bank's "high income" category.
- **Wealth:** Real-estate value *per capita* reached almost US\$50,000 in 2010 – more than four times *per capita* GDP that year.
- **Asset Price:** The cost of buying 100 square meter residential housing in 2011 was estimated to be 9 years of its per capita GDP, as compared to 14 years for China average and 16 years for Shanghai and 17 years for Beijing.
- **Urbanization:** Foshan's urbanization rate, supported by high-quality infrastructure and an advanced industrial sector, reached 94 per cent.
- **Growth Potential:** *Foreign Policy* and the McKinsey Global Institute ranked Foshan as the world's 13th most dynamic city, based on its projected GDP increase from 2010 to 2025.
- **Investment:** Foshan's fixed capital investment as percentage of GDP has stayed steadily at around 30% for last decade, compared to a steady rising trend for China average to about 70% in 2012.
- **Credit:** Foshan also kept surprisingly low ratio of loan to GDP for last decade. It was only 85% in 2012, as compared to 121% for China average, the lowest among the 16 high-income large Chinese cities. Foshan seems to have achieved impressive growth and development under server financial repression.

Reform timeline and GDP per capita



- 1978 Household Responsibility System for agriculture
- 1978-1996 Electricity crisis due to investment restrictions
- 1979 Export-led industrialization
- 1980 Emergence of shadow land market
- 1983 First township, village and private enterprises
- First labor importing programs
- 1984 Foshan toll bridge – first in China
- 1987 Collectives create joint-stock company to manage land
- 1991 First employment permits introduced
- 1992 First healthcare reform: marketization

- Shunde District pilot project on comprehensive governance reform
- 1993 National SOE Reform
- First Chinese TVE that went public – Foshan Midea
- 1994 Emergence of specialized market towns
- New central-local fiscal revenue-sharing
- 1995 Re-employment program for laid off workers
- 2001 Pilot on the use and exchange of collective land
- 2002 Municipal expansion – incorporation of 4 counties
- 2003 Second healthcare reform: expansion of affordable services

- 2003-2006 Second electricity crisis due to installation restrictions
- 2004 Unification of rural and urban *Hukou*
- 2006 Completion of Foshan ring road
- 2007 Pilot project on urban redevelopment
- 2008 Local Government Financing Platforms established
- Shunde District pilot project in departmental streamlining
- Shunde pilot project launched outsourcing public transportation
- Universal healthcare for local residents
- Foshan *Hukou* for skilled migrants
- 2008-Present Third electricity crisis due to

- distorted energy pricing
- 2009 Emergence of microloan companies
- 2010 Completion of Guangzhou-Foshan subway
- Joint training programs between enterprises and schools
- 2011 Pilot project granting Shunde district certain prefecture level privileges
- Restriction on home purchases
- 2012 Worst air pollution in Pearl River Delta recorded

Comparing Foshan's Economy: Productivity, Leverage, & Affordability

11th largest population of 16 High-Income Large Cities in 2012

GDP per capita greater than World Bank's High Income threshold; GDP greater than 100 billion USD; Population greater than 3 million.

	2012				2011	
	Population (m)	GDP Per Capita (USD)	GDP (USD Bn)	Fixed Asset Investment /GDP	Loan/GDP	Cost of 100m ² Housing/GDP Per Capita
China	1,354.0	6,166	8,337	70.2%	121.3%	14.1
1. Shanghai	23.8	13,702	324	26.0%	184.3%	15.8
2. Beijing	20.7	14,040	287	36.1%	221.8%	17.7
3. Tianjin	14.1	14,954	207	68.8%	118.2%	9.2
4. Guangzhou	12.8	16,998	217	27.7%	130.9%	10.3
5. Shenzhen	10.5	19,781	208	17.9%	148.6%	17.1
6. Wuhan	10.1	12,757	128	62.9%	126.9%	8.5
7. Qingdao	8.9	13,270	117	56.9%	102.6%	8.7
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9. Nanjing	8.2	14,208	116	63.3%	162.8%	9.5
10. Ningbo	7.6	18,307	106	44.1%	162.2%	9.9
11. Foshan	7.3	14,647	106	32.2%	84.9%	9.0
12. Shenyang	7.2	12,917	106	85.5%	106.6%	7.0
13. Changsha	7.1	14,429	103	61.8%	113.5%	6.1
14. Suzhou	6.5	18,301	193	42.8%	106.4%	7.9
15. Wuxi	6.5	18,836	121	47.8%	96.2%	6.9
16. Dalian	5.9	16,519	112	80.7%	113.1%	7.7
% of China	12.3%		30.9%	20.1%	37.1%	

Source: CEIC; FGI analysis

Comparing Foshan's Economy: Productivity, Leverage, & Affordability

9th highest GDP per capita of 16 High-Income Large Cities in 2012

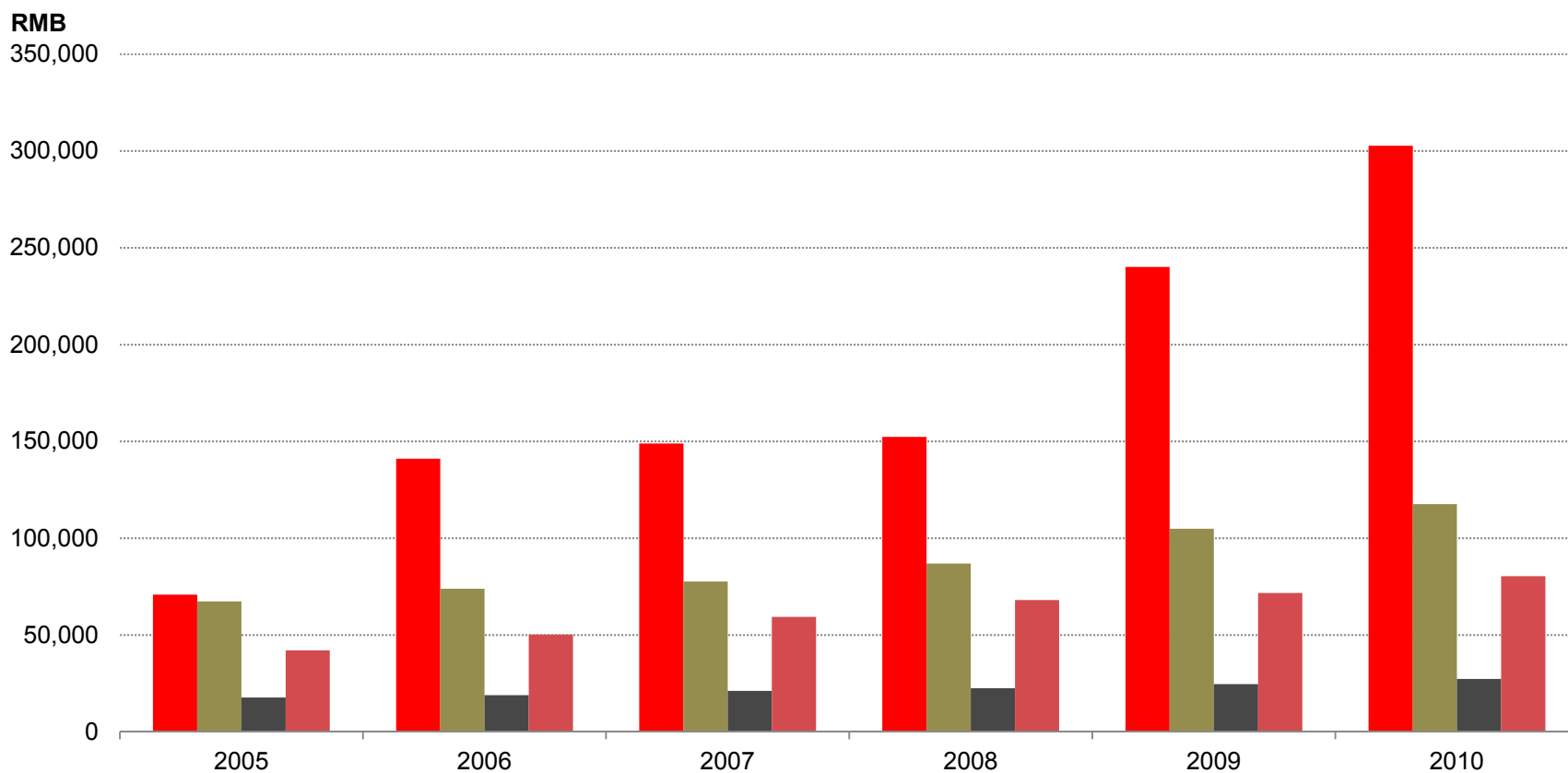
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Income growth & wealth creation driven by property values

Wealth Growth in Foshan (RMB)

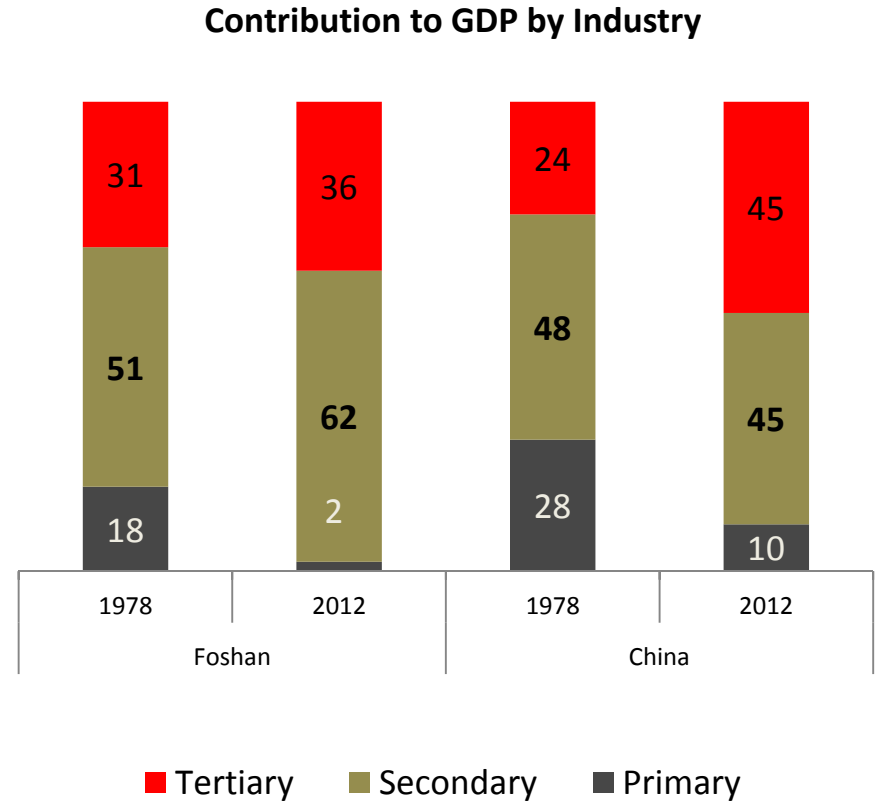
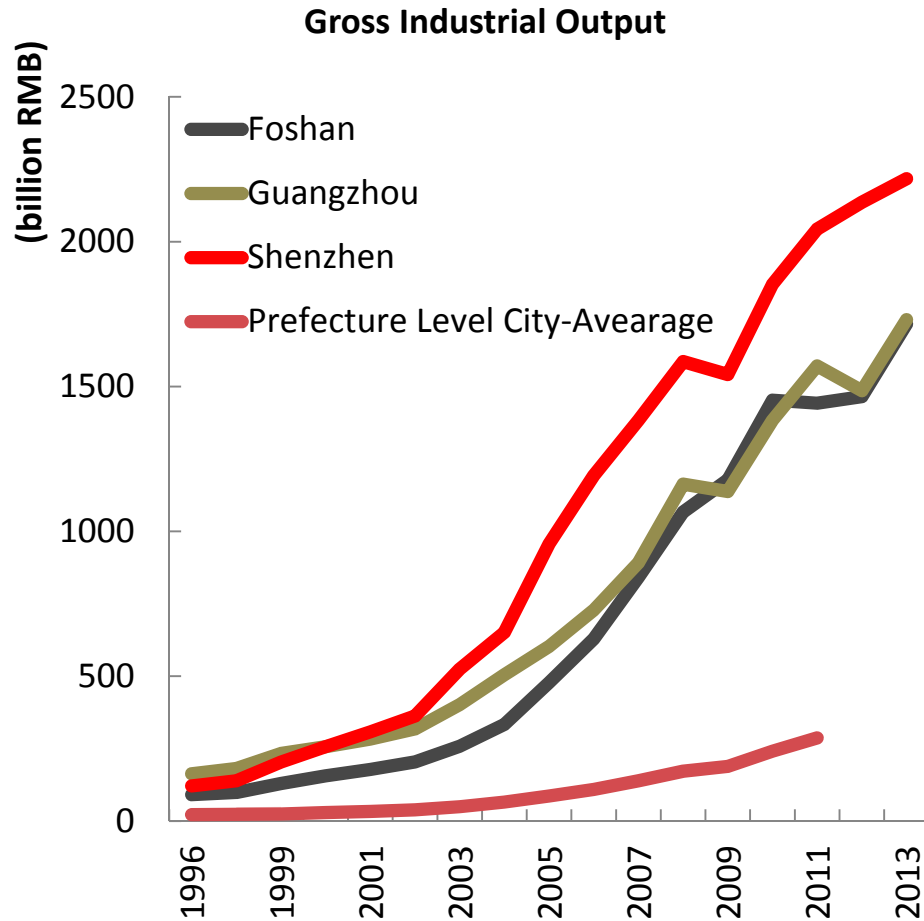
■ Property value per capita ■ Deposit per capita ■ Disposable income ■ GDP per capita



Becoming an Industrial Powerhouse

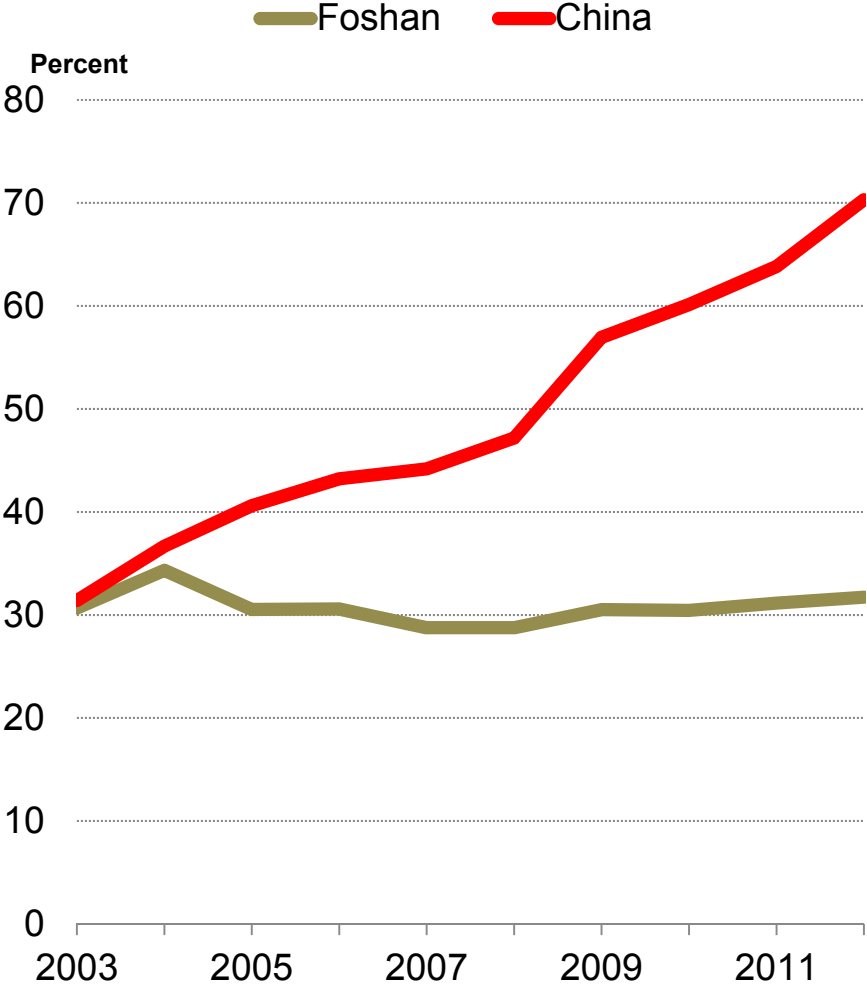
5th highest value of industrial output among Chinese cities in 2010

During 1978-2012, industry as a share of GDP expanded 11pp, compared with the national average of -3pp.

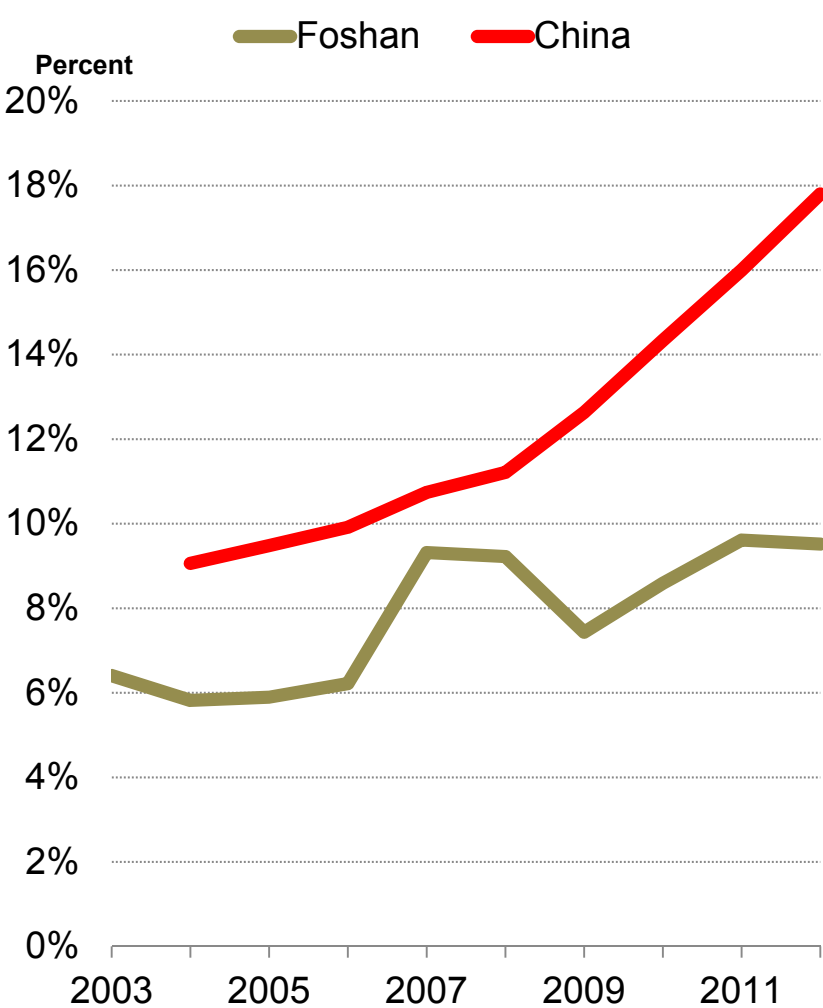


Low and stable FAI & property investment: A result of financial repression or self-discipline?

Fixed Asset Investment as % of GDP



Real Estate Investment as % of GDP



Source: CEIC

Comparing Foshan's Economy: Productivity, Leverage, & Affordability

4th lowest FAI / GDP of 16 High-Income Large Cities in 2012

GDP per capita greater than World Bank's High Income threshold; GDP greater than 100 billion USD; Population greater than 3 million.

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Comparing Foshan's Economy: Productivity, Leverage, & Affordability

Lowest loans to GDP ratio of China's 16 High-Income Large Cities in 2012

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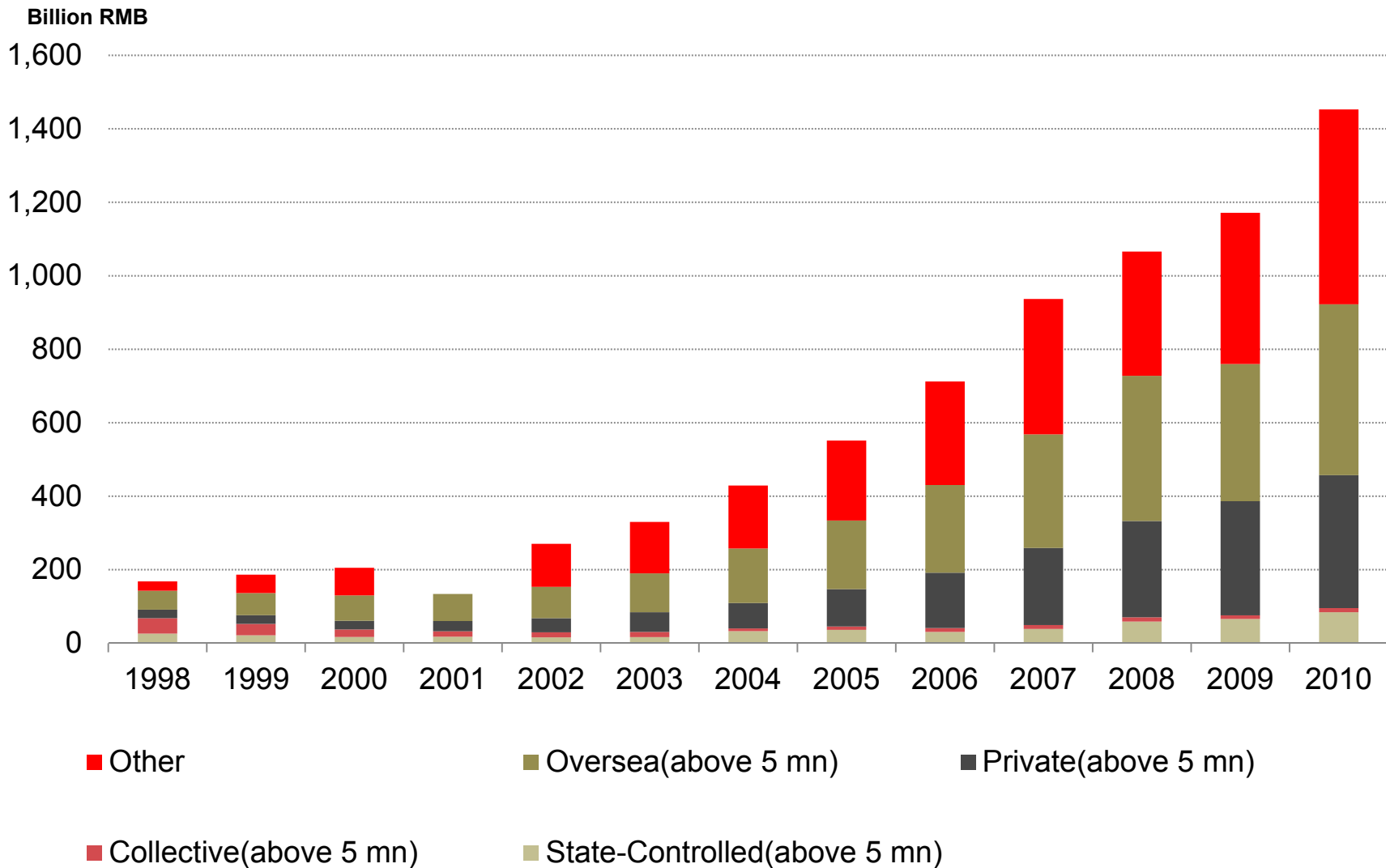
Source: CEIC; FGI analysis

The 2nd Surprise: most practices seem replicable (geography, history and culture are exceptions)

- **Private-sector-led growth:** The private sector of Foshan contributed about 61% of its GDP and about 93% of its Industrial Output. The city has one private enterprise for every 20 residents.
- **Production for domestic markets:** Foshan's net exports declined from 30 per cent of GDP in 2006 to 18 per cent in 2012, reflecting a steadier shift to domestic markets than occurred in other Chinese manufacturing cities like Wenzhou (25 per cent of GDP), Dongguan (32 per cent), and Shenzhen (37 per cent).
- **Globally connected, specialized markets:** Foshan has more than 30 specialized market towns with sophisticated industrial clusters and local supply chains linked to international markets.
- **High-quality migrant labor:** More than half of Foshan's population are migrants, who enjoy relatively good access to the key social services, owing to reforms in vocational training, health care, housing, and social security.
- **Greater local autonomy:** By delegating significant fiscal and management responsibility to county, township, and village officials, Foshan's government was able to stop acting as a substitute for the market, and begin facilitating and supporting market growth.

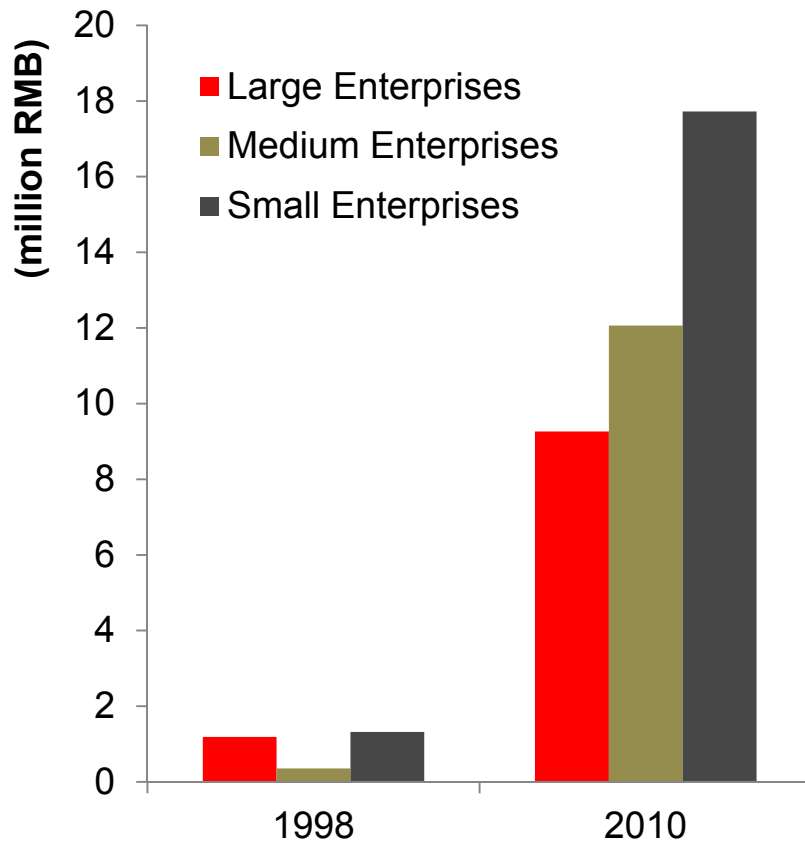
**Non-state sector produces >90% of industrial output:
The market has been decisive for more than a decade**

Foshan industrial output and by firm ownership type

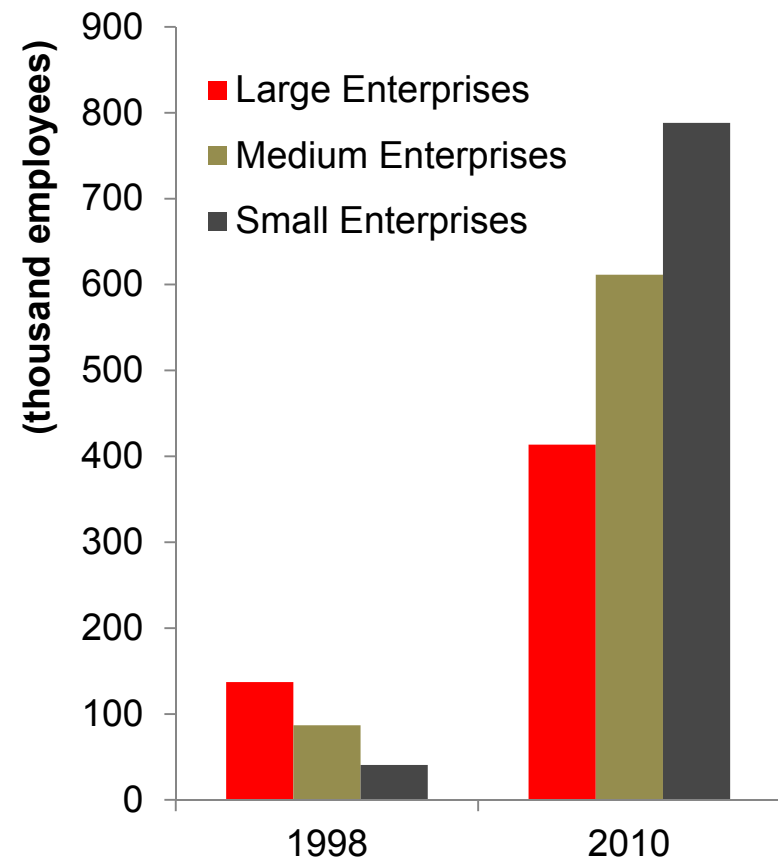


A City of SMEs: >70% of GDP & jobs from SMEs

Output by enterprise size



Employment by enterprise size

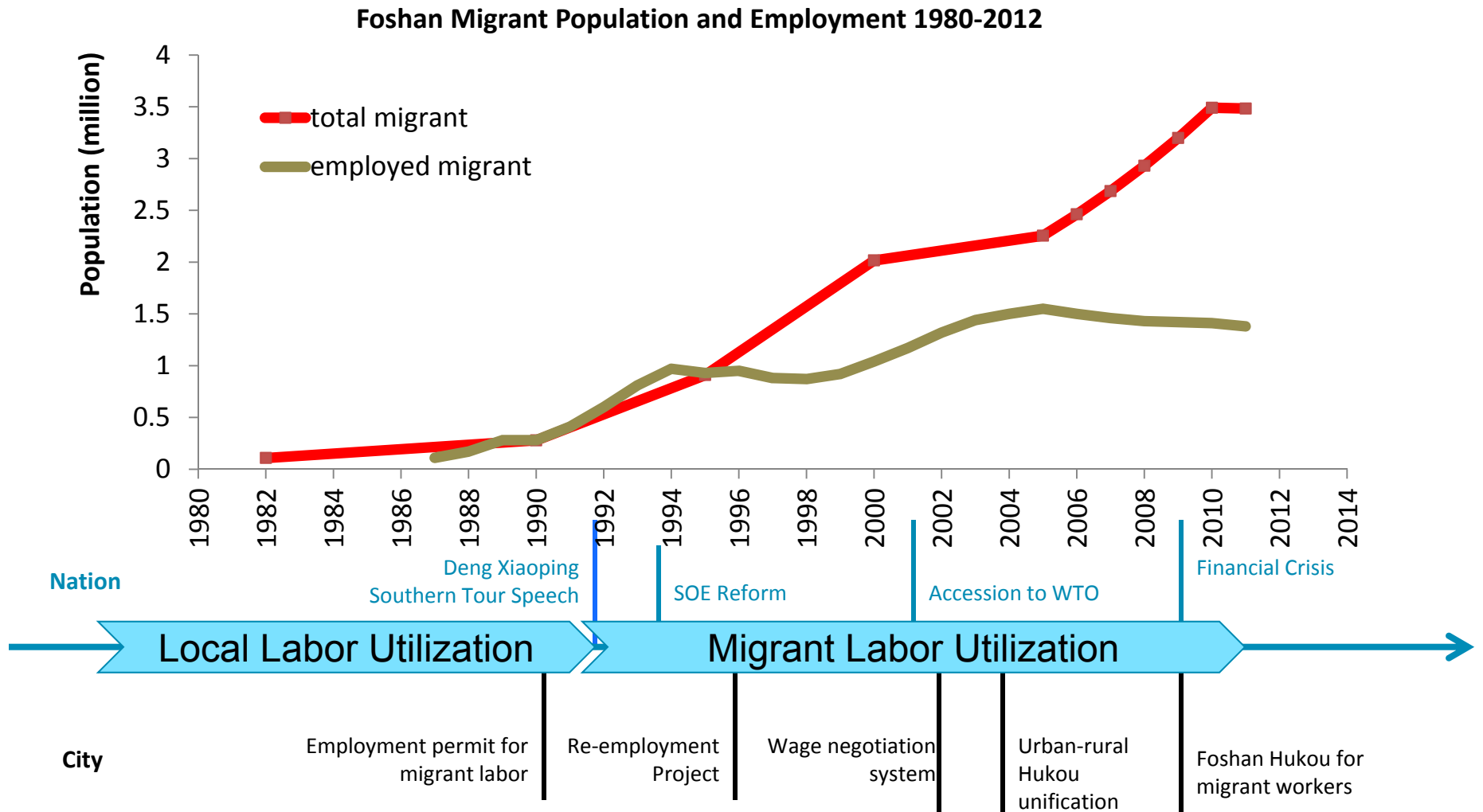


Transitioning demand: from export to domestic markets

Net exports as percentage of GDP

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Shenzhen	16	33	47	53	52	45	42	42	37
Dongguan	42	28	31	31	33	29	27	28	32
Wenzhou	19	23	27	27	28	23	27	27	25
Foshan	30	28	30	29	24	15	17	18	18
Chongqing	1	2	2	2	2	1	2	7	
Wuhan	-2	-4	-1	-1	0	0	-1	-1	1
Guangzhou	-4	0	1	2	3	-1	-4	-2	0
Shanghai	-13	-4	0	3	8	3	-3	-6	-7
Tianjin	-1	3	4	7	4	-4	-5	-8	

Growing migrant population and employment until 2010



Note: Data on migrant population have minor conflicts before 1995. Seasonal migrants are sometimes not recorded.
 Source: Foshan Statistical Yearbook, 1978-2010.

Comparing Foshan's Economy: Productivity, Leverage, & Affordability

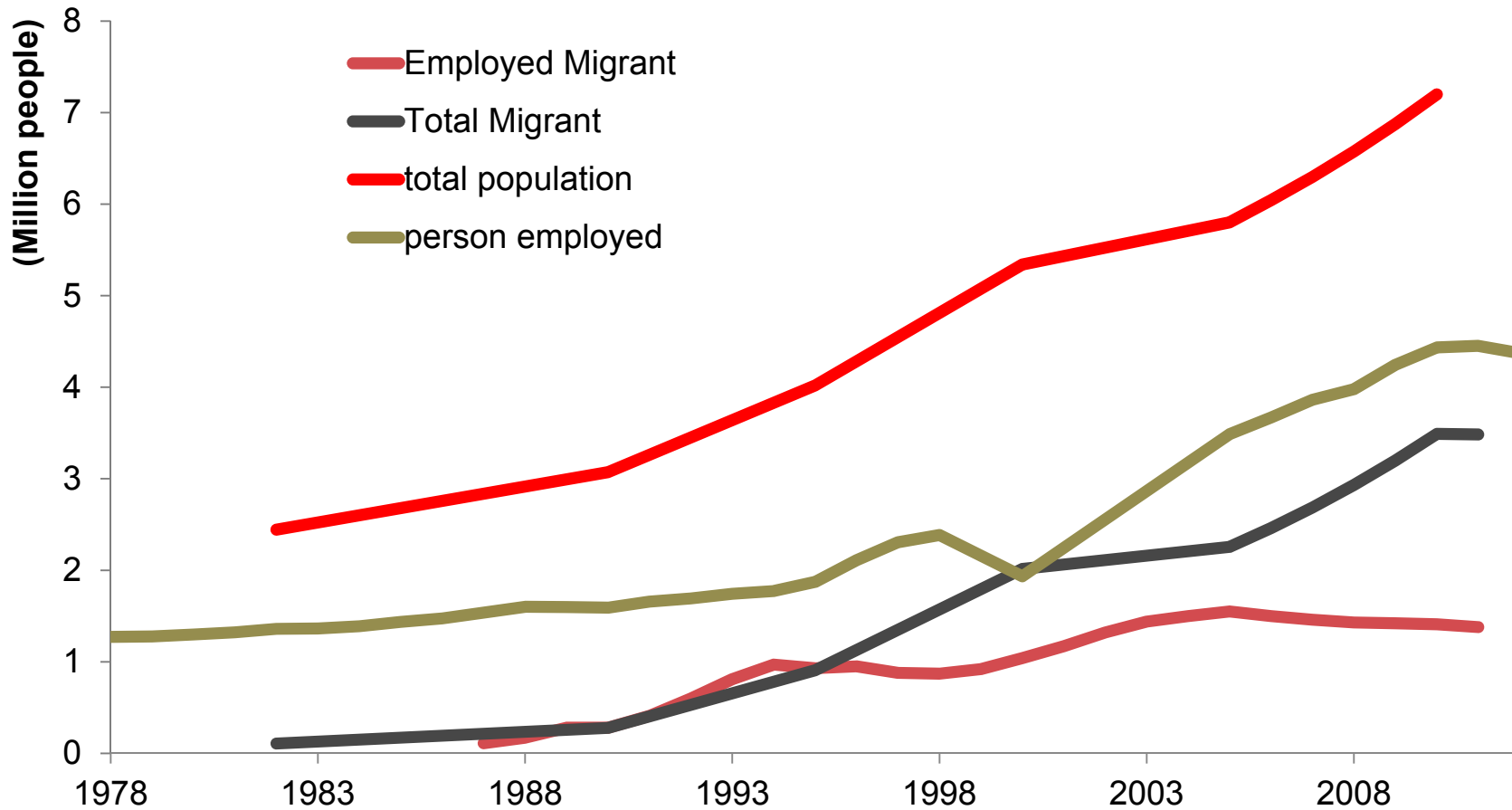
8th highest cost of housing to GDP/capita of China's 16 High-Income Large Cities in 2012

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Population Boom Continues: attracting & retaining workers & families

Foshan's Total and Migrant Population and Employment: 1982-2011



Competition among districts, towns, and villages

Local autonomy
Regional competition



Diversification
Low risks of following
wrong industry policy



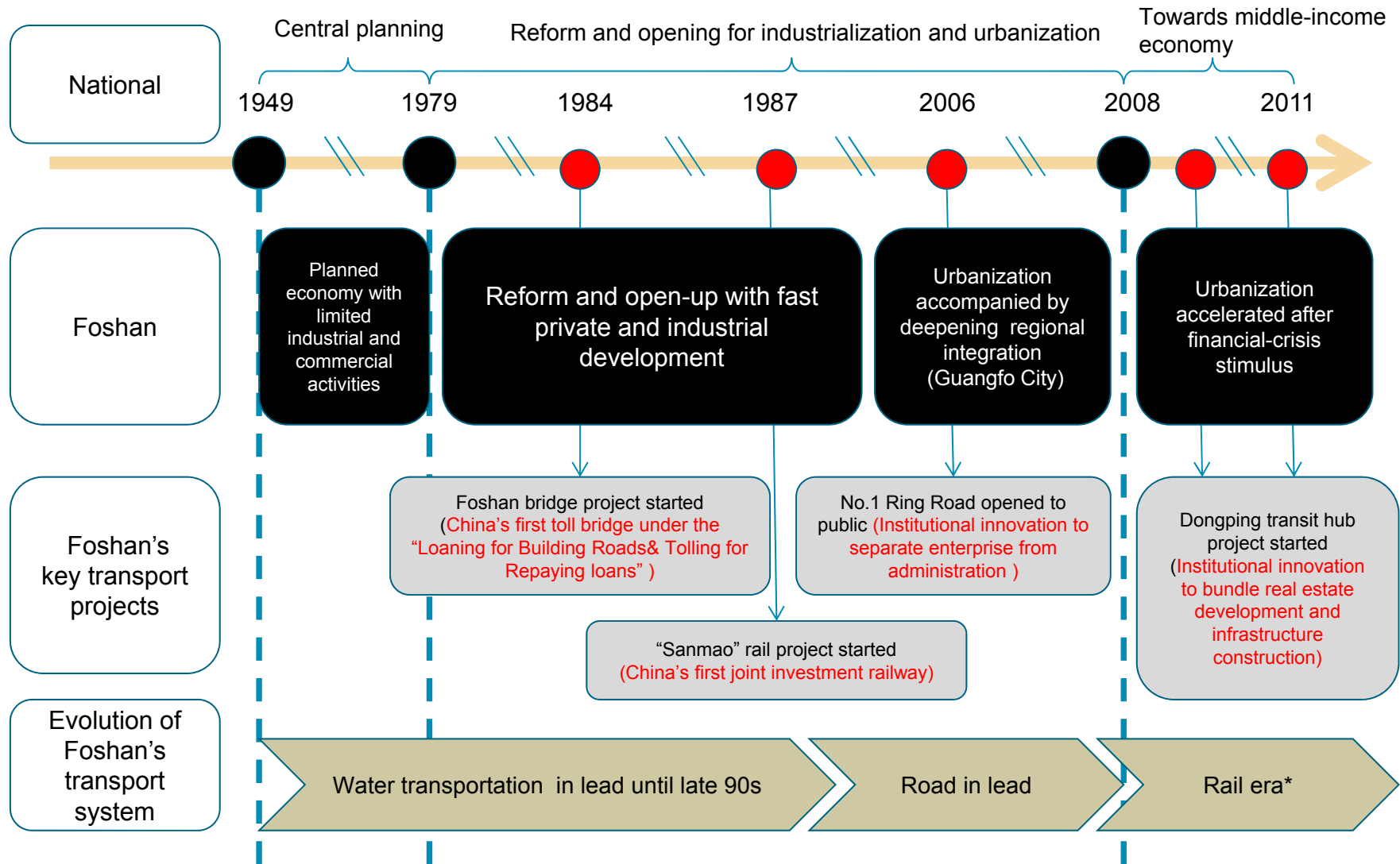
Relatively stable city
economic growth and
development



The 3rd surprise: swim or die! No other options

- ***Why have only Foshan and a few other Chinese cities taken such market-oriented reforms, even though all Chinese cities could have done so easily?***
 - Foshan’s Mayor (Now Party Secretary), Mr. Liu Yuelun, explained: Foshan “had to rely on the market to get the people, capital, resources, infrastructure, technology, and sales for its growth.”
 - Foshan is not an SEZ, is not directly controlled by central or a provincial governments, and is not rich in natural resources.
 - Consequently, the market (not the state) played the key role in resource allocation.

Infrastructure in Foshan: “If you want to get rich, build roads first”

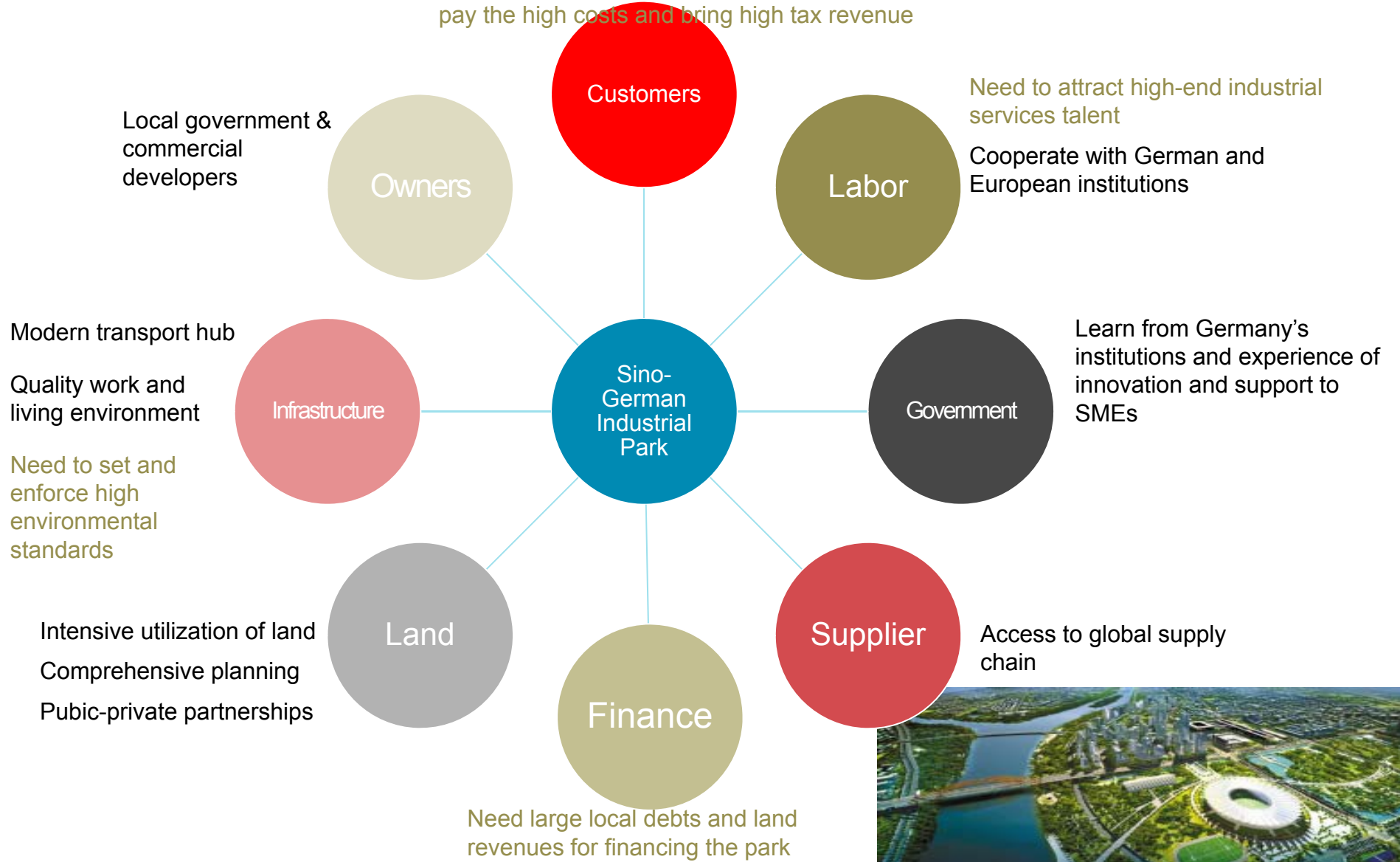


*Note: “Wuguang” & “Guangzhu” established; “Guiguang” & “Nanguang” projects started; “Guangfo” line opened to traffic

Local response: Foshan Sino-German Industrial Services Zone

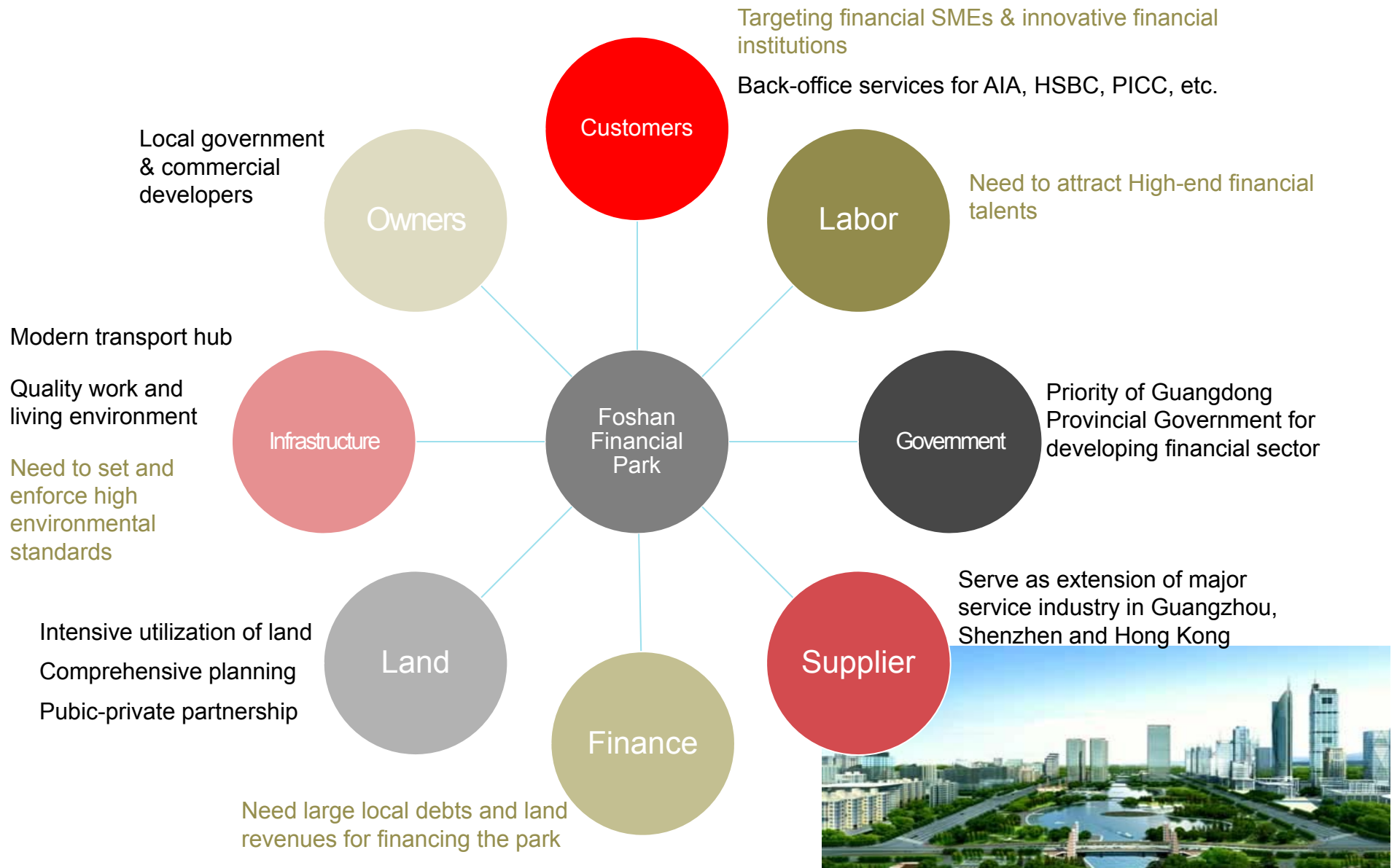
Ghost Town or Platform for Industrial Upgrading?

Need to attract globally competitive enterprises who can pay the high costs and bring high tax revenue



Local response: Foshan Guangdong High Tech Service Zone for Financial Institutions

Ghost office block or future CBD?

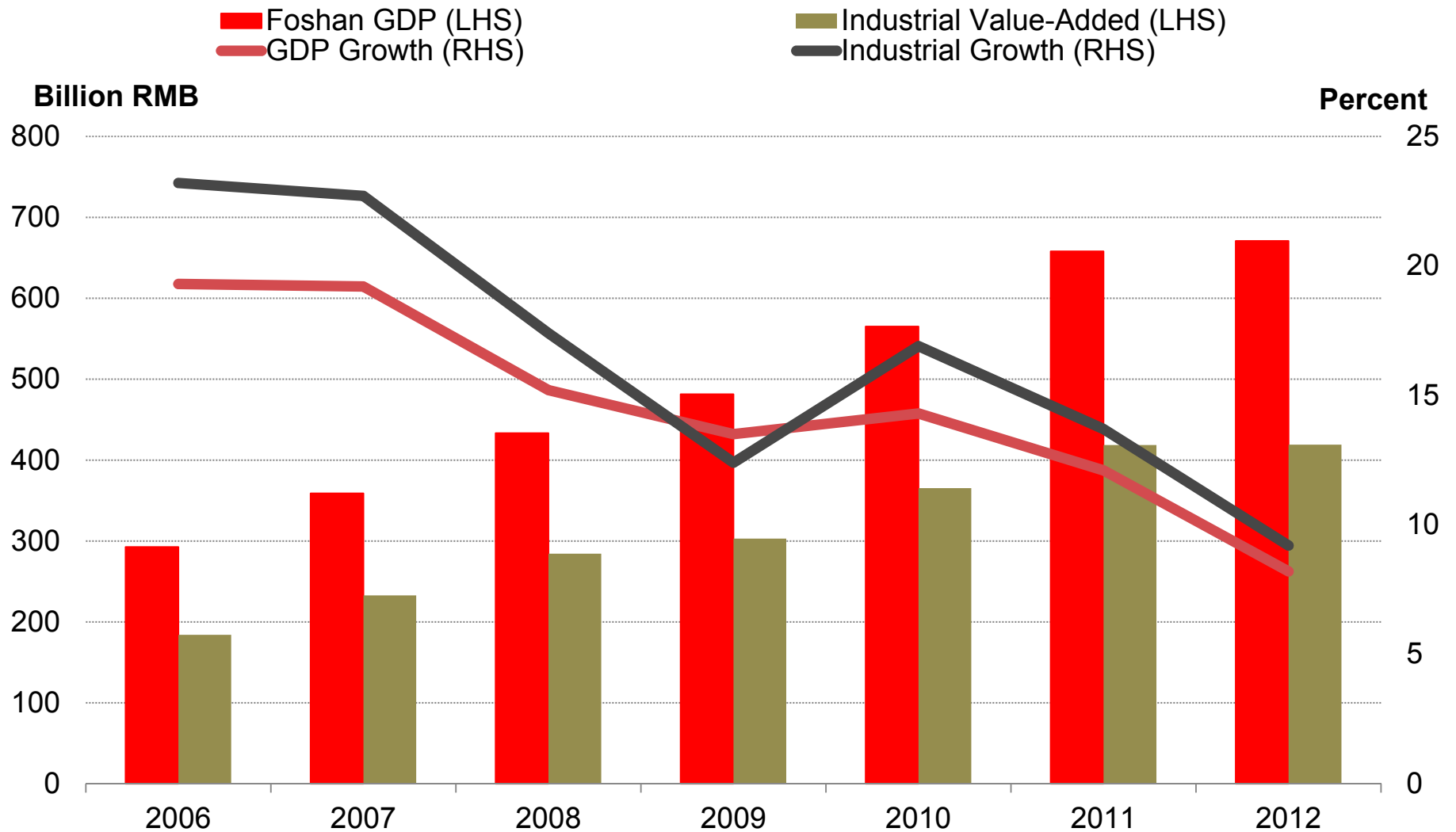


The 4th Surprise: Same problems and challenges

- ***Foshan's key economic challenges (local-government debt, credit access for SMEs, and pollution) are identical to those facing China as a whole.***
 - **Local debt and infrastructure development:** In 2012, debt-service costs amounted to 47 per cent of its fiscal revenue. It was mostly financed through extra-budgetary land sales. However fixed-capital investments since 2004 amount to ~30% of GDP, putting Foshan in a reasonably strong position. Some local government investments amount to 70% of their GDP.
 - **SME credit access and industrial upgrading:** SME credit access is a challenging problem. Local SMEs must to pay shadow-banking interest rates higher than 20%, limiting growth, innovation and job creation. Macroeconomic policies, though necessary, may be insufficient to enforce credit discipline over both private and state-owned borrowers. Parallel institutional reform (planning, regulation, and bankruptcy procedures) are also necessary.
 - **Pollution and sustainable development:** Developing cleaner industries is necessary. But, unless nearby cities do the same, such efforts will have minimal impact. Collective action is needed to improve standards, expand public education, promote innovation in science and technology, and enforce rules more effectively.

GDP and industrial growth: slowing inline with the national average

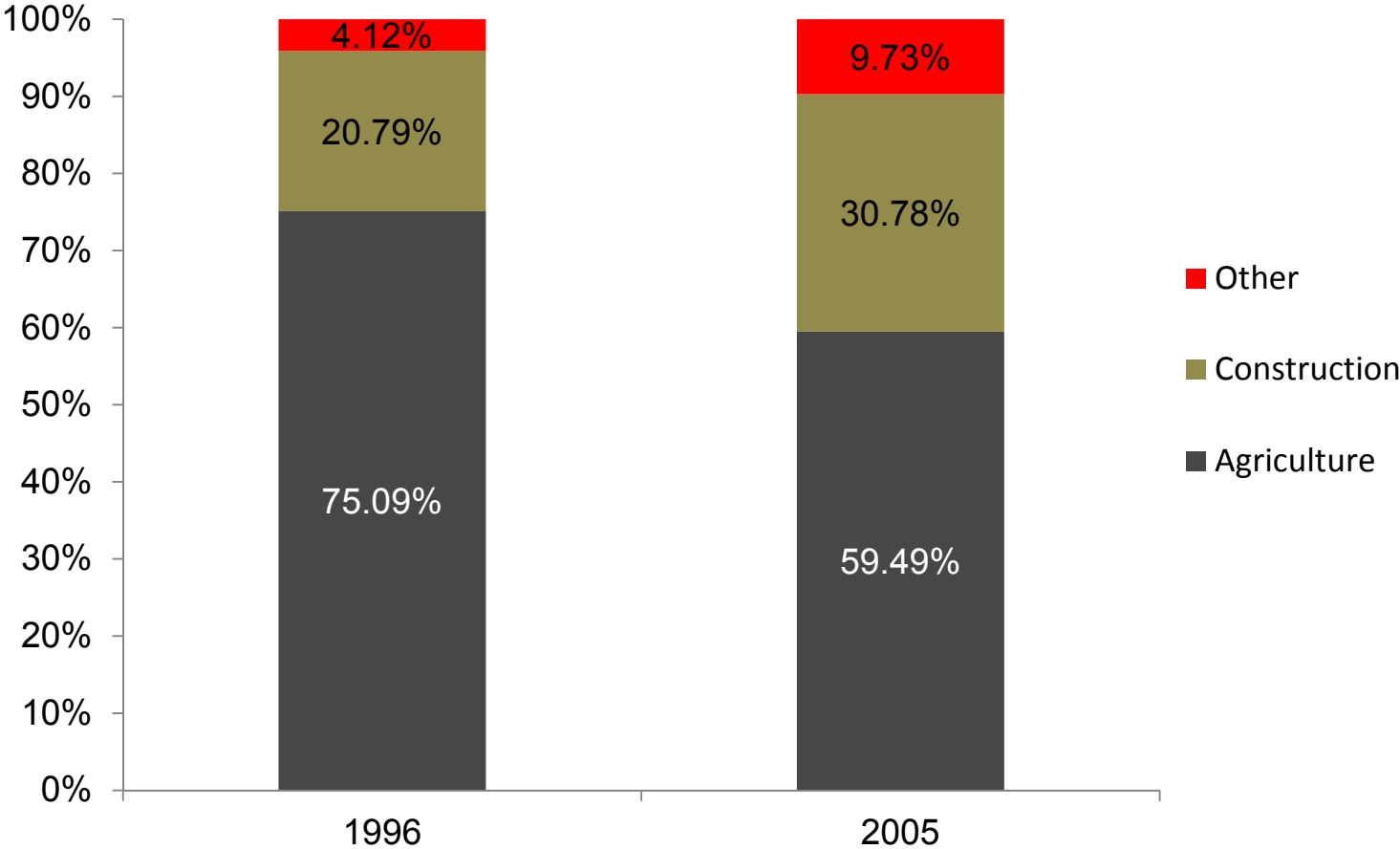
Foshan GDP and Industrial Growth



Land revenue: 2011-2012 bump reflects industrial park developments

	Land revenue <i>RMB hundred million</i>	Local government budgetary fiscal revenue <i>RMB hundred million</i>	Land revenue as percentage of budgetary revenue <i>Percent</i>
China			
2010	27,100	40,613	67%
2011	31,500	52,547	60%
2012	26,900	61,078	44%
Foshan			
2010	193	306	63%
2011	271	342	79%
2012	278	384	72%

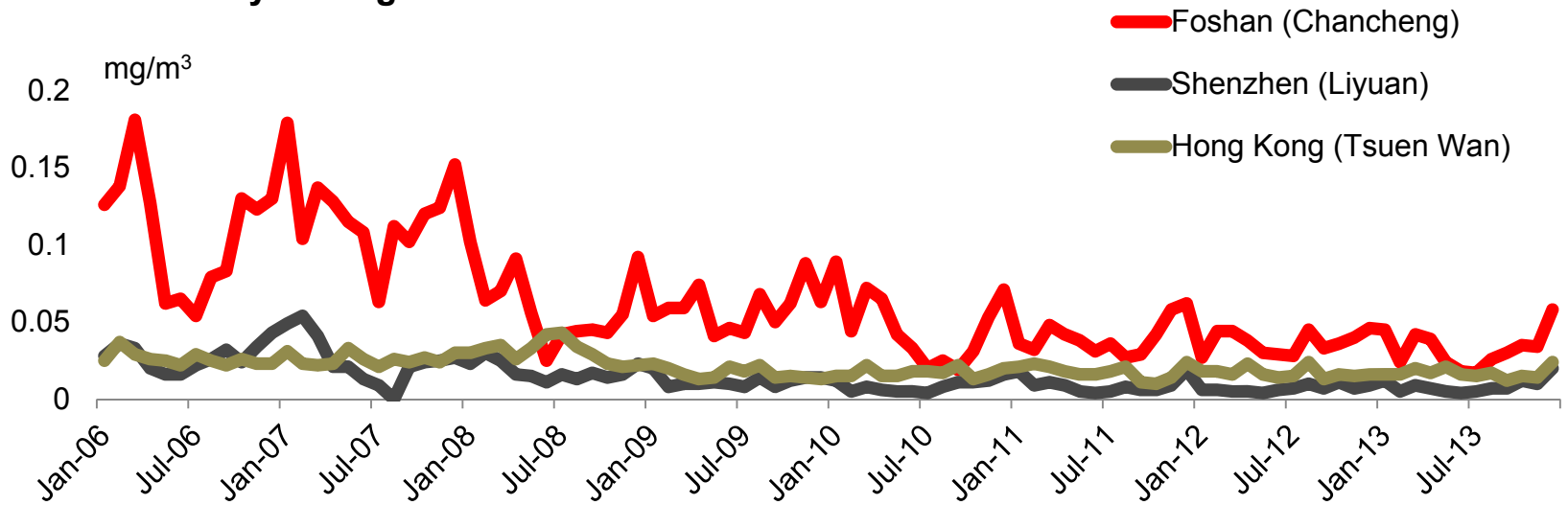
Land Use: industry & construction gains, agriculture & environment loses



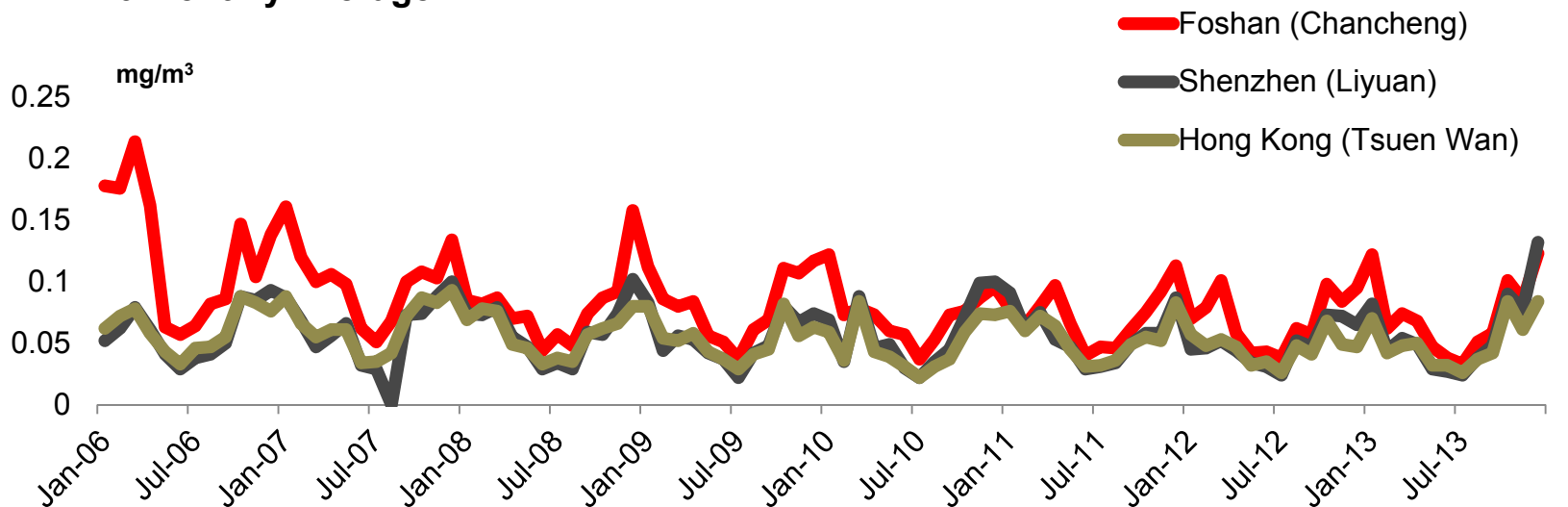
Source: Foshan General Land Use Planning (2006-2020) and (1997-2010); FGI analysis.

Pollution: A serious but improving issue for employers & employees

SO2 Monthly Average



PM-10 Monthly Average



Source: Regional Air Quality Monitoring Network; FGI analysis

Thank You



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