Shanghai: China's Nexus to the Global Economy

by Edward Leman

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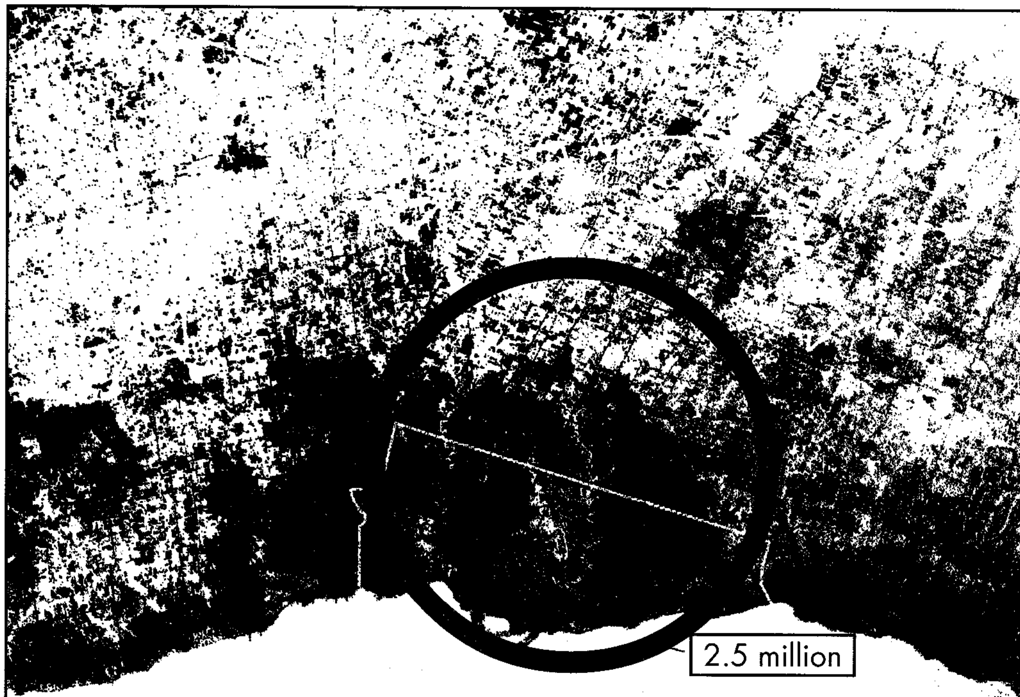
Shanghai, China's largest city, has a population of 16 million, including migrant workers. It now has the highest level of per-capita Gross Domestic Product (GDP), the highest gross value of industrial output, the largest turnover of freight volume, the highest volume of retail sales, and the largest number of tourist visits of any city in the country. A decade ago the city was stuck in a pre-reform rut of central planning, outdated economics, heavy industry, and a dangerous dependence on state-owned enterprises. Changes in the past decade have been phenomenal: CCBC members visiting Shanghai for the first time to attend this year's AGM will be struck by the verve, cosmopolitanism, and sheer speed of development as the city celebrates its re-emergent role as China's principal centre of commerce.

Figure 1 (next page) puts the city into physical perspective: both satellite images of Shanghai and Toronto are to the same scale. Shanghai has four times the population of the Greater Toronto Area on about 10% less land. At these densities, the population of Ontario, Manitoba, Saskatchewan, and Alberta would fit into an area stretching from Newmarket to Toronto's waterfront, and from Scarborough to the western edge of Etobicoke.

Figure 1
Comparison of Shanghai and Toronto



	Area	Population	Density
Greater Toronto Area	7,060 km^2	4 million	567 inh/km^2
Shanghai Municipality	6,340 km^2	16 million	2,523 inh/km^2

Source: Shanghai Municipal Statisfical Bureau; Chreod data

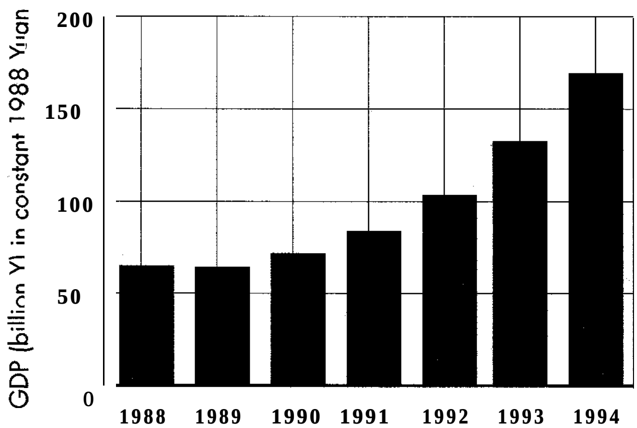


Figure 2
Real Growth in GDP

Source: Shanghai Municipal Stotistical Bureau; Chreod data

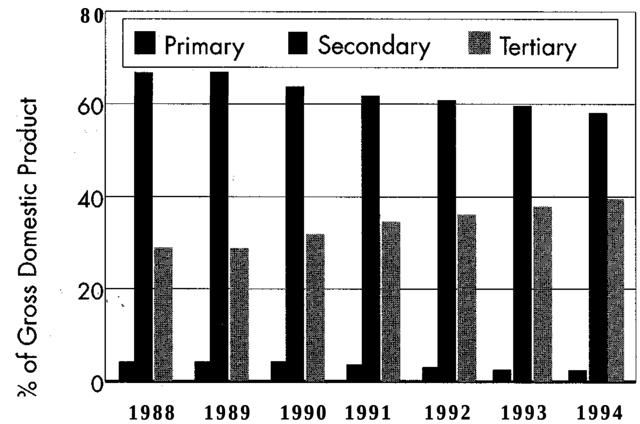


Figure 3
Economic Restructuring

Source: Shanghai Municipal Statistical Bureau; Chreod data

How sustainable is Shanghai's growth? Figure 2 (above) shows actual GDP since 1988 discounted for inflation. The city's GDP has more than doubled in real terms during this period. Not only has the economy grown, but it is diversifying quite rapidly away from industry into the services sector. Industry's role has declined from 67% of GDP in 1988 to 58% in 1994, while services have grown from 29% to 40% (Figure 3, above). At this rate of change, services will account for at least 60% of Shanghai's GDP by the end of this decade — the same ratio as in Singapore in 1995 — clearly making Shanghai China's commercial and financial centre and an important player in the Asia Pacific region.

An indication of the city's outward orientation can be seen in Figure 4 (below), which shows the role of exports in the economy over the last seven years. While exports' contribution to GDP declined somewhat in 1993, it almost reached 40% of GDP in 1994, up from around 25% in 1988. This reliance on exports is high when compared to other locations in the region: exports account for around 25% of South Korea's GDP and 35% of Thailand's GDP. Shanghai's growing reliance on trade, both within Asia and with North America and Europe, is clear evidence of the city's entry into the global economy, a trend that shows every indication of continuing well into the next century.

Shanghai's citizens are, on average, getting richer and saving more. Figure 5 (below) shows how household savings are growing as a relative share of the city's overall economy, i.e., savings are growing not only in absolute terms, but as a proportion of GDP. At almost 50% of GDP, these savings rates are almost higher than in Singapore (55.6%), and much higher than in Hong Kong (34.5%), South Korea (37%), Taiwan (26.3%), and Thailand (34.2%). These savings rates provide strong support for the/fundamentals of Shanghai's new economy. As domestic capital markets continue to mature over

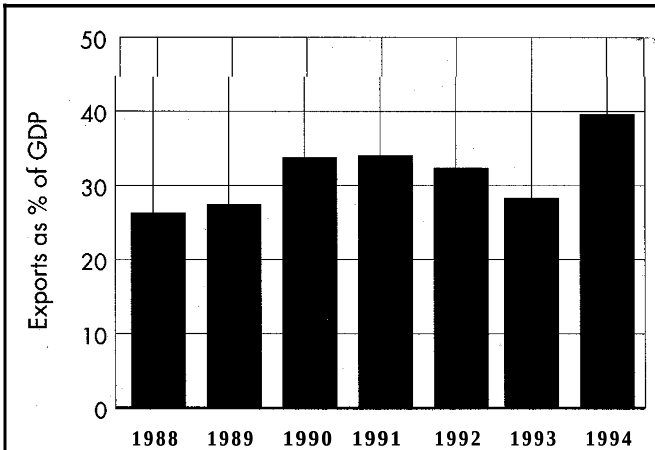


Figure 4
Role of Exports

Source: Shanghai Municipal Statistical Bureau; Chreod data

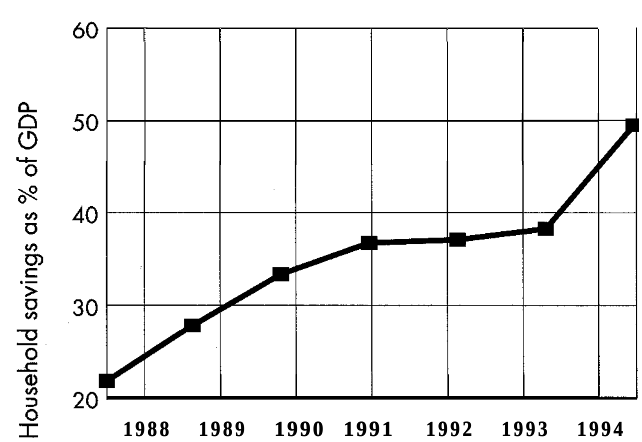


Figure 5
Rapid Rise in Household Savings

Source: Shanghai Municipal Statistical Bureau; Chreod data

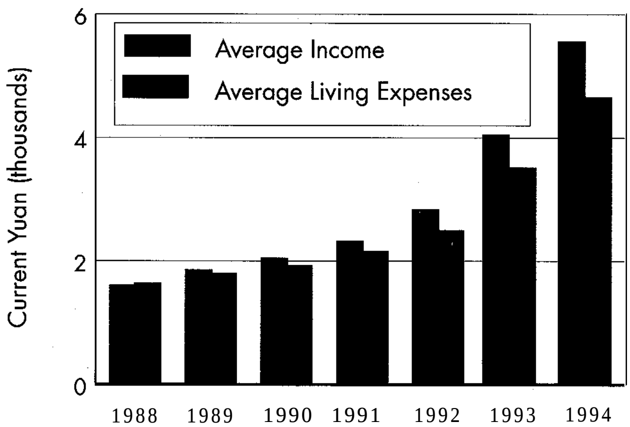


Figure 6
Growing Disposable Incomes
Source: Shanghai Municipal Statisfical Bureau; Chreod data

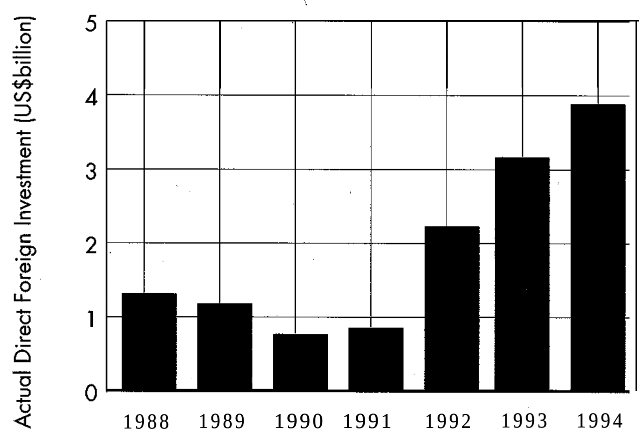


Figure 7
Actual Direct Foreign Investment
Source: Shanghai Municipal Statistical Bureau; Chreod data

the next few years, enormous pools of local capital will open for investment into the city's industries, services, and infrastructure development.

Figure 6 (above) indicates that discretionary incomes have been rising quickly since the start of this decade. These statistics are for officially declared incomes from formal salaries; the reality is that a typical middle-income household in Shanghai today earns only an average of 30% of gross household income from formal salaries. Therefore actual discretionary incomes after basic living expenditures are much higher than what is shown.

Foreign investors are obviously taking note of both the city's rapid orientation to foreign markets, and the (still latent) purchasing power of domestic consumers. There are now over 4,000 foreign-invested companies in Shanghai. Aggregate actual (not just-committed) investment between 1988 and 1994 totalled US$13.5 billion; this compares with around US$16.5 billion in Thailand, US$14 billion in Taiwan, and US$12 billion in South Korea during this period. Figure 7 (above) shows the huge jump in foreign investment since 1991. Figure 8 (next page) shows that foreign investment is playing an increasingly important role in the city's economy, accounting for almost one-fifth of GDP in 1994. However, investment from Canadian companies so far is miniscule: Canada's actual investment of US$45,740,000 in 1994 represented only 1.4% of DFI in Shanghai that year.

Earlier visitors to Shanghai will remember the enormous traffic jams, poor telephone service, and overall lack of infrastructure. Governments' commitment in recent years to transform Shanghai into an "international city" has not been empty rhetoric. Figure 9 (next page) shows that actual investment in infrastructure as a proportion of overall GDP has been rising since 1990, and rose quite rapidly in 1993 and 1994, when major roads, subways, water infrastructure, power, and telecommunications capacities were put into place. The impact of these ongoing investments is becoming clear: where one could only expect to hold three meetings a day in the city due to traffic congestion, most business people can now schedule five. Telephone access on IDD (International Direct Dial) and DDD (Domestic Direct Dial) is now virtually assured. Industries are no longer concerned about accessing sufficient water, although power remains a concern. The increase in infrastructure investment relative to GDP is quite exceptional in China: in the course of our work across China for various multilateral agencies, we have repeatedly found that most cities have been unable to match their infrastructure investments to economic growth. Shanghai is a notable exception, partly due to central government support, but also as a result of innovative financing mechanisms that have been implemented in the city.

There are, however, some wild cards in Shanghai's future, of which Canadian companies should be aware. The first is Hong Kong's rejoining China in 1997, and the impact that this might have on Shanghai's continued rapid growth into a commercial and financial nexus. Although there would appear to be room for "several Hong Kongs" in China, if given the choice for a "China base," foreign investors may favour Hong Kong with its superior infrastructure, better airline connections, better support services, and more transparent regulatory environment.

Shanghai's increasing reliance on exports makes it vulnerable to international trade shocks and economic downturns in foreign markets. Much of Shanghai's trade, however, is inter-Asian and therefore less prone to major disruptions (short of war). In addition, by the end of this decade, Shanghai will be connected by highways to a huge domestic market of 465 million consumers within a two-day drive; this local demand provides an important economic buffer to external shocks. An important social wild card is Shanghai's attraction to poor, rural migrants seeking employment. There are already an estimated three million migrants in the city at the present time.

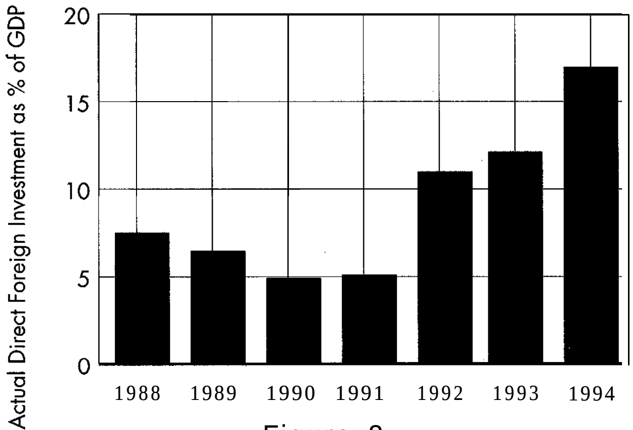


Figure 8
Role of Foreign Investment in Shanghai's Economy

Source: Shanghai Municipal Statistical Bureau; Chreod data

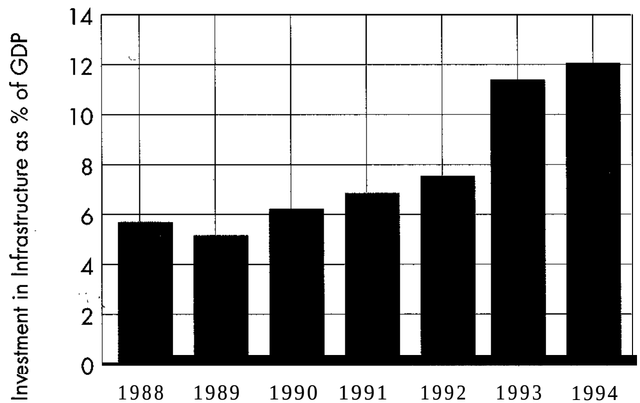


Figure 9
Rapid Increase in Infrastructure Investment

Source: Shanghai Municipal Statistical Bureau; Chreod data

Although they are a source of cheap labour for jobs that Shanghai residents will no longer perform, migrants put pressure on housing, social services, and infrastructure that must be addressed by municipal authorities. Equally important is the huge number of redundant workers in Shanghai's state-owned enterprises; as these firms reorganize, thousands of workers are finding themselves underemployed and being paid minimal wages to sit at home. In the context of growing wealth among Shanghai's middle class, increasing income disparities need to be keenly monitored.

A final wild card is infrastructure. Although the government has committed huge amounts from its consolidated municipal budgets to building major capital projects over the last few years, given the credit squeeze in China and the drying up of concessional lending from multilateral agencies, the question arises of how the municipal government will continue to finance infrastructure improvements necessary to assure Shanghai's comparative advantages in the global marketplace. Of all major cities in China, however, Shanghai appears to be consciously working to structure reforms through which private investment in the city's infrastructure can fill budget gaps, and through which consumers will begin to pay full market prices for infrastructure services. If successful, both reforms will be another first in China for Shanghai. C