

12. Where should China be heading?

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Topics

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1 What may be learned from the Chinese experience?

What can be learned from the Chinese experience?

- An open market economy is a good model, but political stability and an effective government are also indispensable (credit to the CCP?)
- A gradual transition is better than a shock therapy (compared with other transitional economies)
- Moving from goods markets to factor markets is a good logic
- The export/investment-led growth model may work for a while, especially when it is supported by complementary credit expansion

Three key steps

- The dual-track approach and profit retention in the 1978-1995
- Fit China into the WTO-consistent framework of a market economy in 1996-2008

- Move onto the world stage as a global economic and political power in 2009-present and play a constructive role in shaping a post-WTO architecture for the global economy
- Two critical issues are:
 - how to define the balance between government and market in negotiating trade deals (*i.e.*, RCEP)
 - how to build an international financial architecture with multiple reserve currencies

Some controversial ideas

- The party/government has a substantive (decisive?) role to play
- Industrial policy to promote products/sectors that are not profitable now but may be competitive in the future
- Produce and pollute first, protect environment later?
- Print money to fund investment
- A constrained role for the private sector and democracy under the domination of the party and SOEs

Key points

- In comparison, the Chinese experience of the transition to a market economy is regarded as more successful, but how to draw lessons is more controversial
- One lesson is that capitalist market beats socialist central planning, so the mission of the communist party is over
- But it is argued that a gradual approach under the authoritarian party is less bumpy
- Whether the CCP adds or subtracts value to the Chinese economy is another controversy
- The party argues that the central control through the CCP enables China to concentrate resources for large undertakings, important for a global power
- But it can be rebutted that many such large undertakings are pretentious, and do not benefit ordinary people

2 How much has China been “reformed and opened”

How much has China been reformed and opened?

- Prices play the dominant role in guiding production and consumption, while traditional central planning is gone
- China has become a world factory and offers a friendly and competitive business environment for FDI
- However, there are still too many sectors dominated by SOEs and not fully open to private and foreign enterprises
- China has been largely industrialized, but not yet fully urbanized
- Migrant workers and 250 million “floating” population are a salient hallmark in China’s landscape

Chinese characteristics

- The Party still controls the government and a major chunk of the economy
- Land is not privatized
- Large corporations are effectively party controlled, even though they look similar to private businesses in structure
- Government and business are often intermingled, especially at local levels in setting up development zones and expanding urban space by converting rural land into commercial and residential uses.

Mixed performance

- China is now the second largest economy and the biggest trader
- Income distribution is pyramid-shaped, with a huge bottom with widening disparities in income and wealth
- Political power and financial wealth are intermingled with worsening corruption
- Food is not safe, air is dirty, and the environment is severely degraded

Has the export-led growth model run out of gas?

- The supply of cheap rural labor is approaching the limit
- The rural-urban divide leads to social tensions and distorts urbanization
- Local governments are too fixated on attracting factories and expanding urban land in the pursuit of GDP growth
- With feeble external demand, excess production capacity is everywhere and, a financial, social and environmental crisis is looming menacingly

Key points

- China is only half way in transition to a market economy
- A real market economy is built on freedom and equality for individuals with democratically elected government serving ordinary people
- The CCP wants to keep party control, enslaving ordinary people to serve the party and the ruler
- So *a market economy with Chinese characteristics* is not recognized outside China as a true market economy
- China is not even *a socialist market economy* as claimed, because true socialism means “to each according to his need”, but in China it is “to each according to his rank”

3 Where should China be heading?

The landscape that may remain

- The party and government leadership has recently been passed to Xi Jinping and Li Keqiang, who still believe that the Party can be rejuvenated and corruption be checked and cleaned
- They have carried out a vigorous anti-corruption campaign, determined to implement the rule of law, and sharply shrink the power of the party and government officials, but power is surrendered upwards to the master not downwards to the people
- A closely organized and disciplined Party can be a double-edged sword
- This authoritarian model of party control puts China at odds with the democratic world
- It is an open question whether such an authoritarian regime is derived from the belief in Communism or the Chinese feudal dynasties

The priority list

- The new people-centered urbanization drive that can settle down new migrants and is not preoccupied with building new houses and roads
- Improve income distribution by lifting the wage floor and extend the coverage of a national social insurance system to all, especially rural residents
- Be really serious with containing pollution and expanding clean energy
- Pushing for a global power with a global currency and lots of outward investments?

Who supports more market but less Party?

- The working class on the social floor.
- Enlightened reformers within the party.
- Some people in the business sector who may benefit from the structural change, such as those who may enter the sectors now dominated by SOEs and new internet-plus businesses.
- Perhaps, the emerging middle class and intellectuals in general.

Who want to keep the status quo?

- The export sector that profits from cheap Chinese labor.
- The related business-government-party power nexus which forms the mainstay within the Party.
- A significant portion of urban residents who are not keen to share their urban privileges, especially those who possess many urban houses. They would oppose the introduction of a property/inheritance tax.

Major risks ahead

- Excess capacity in many industries and empty cities and houses
- The high level of debt associated with them, a big chunk of which will turn bad
- The existing funding model for urban development appears to be shaky, with bubbly house prices
- There are high risks in the One Belt One Road Initiative and pushing the yuan as a global currency

The vision from the CPC's 18/3rd plenum

- There will be a new round of “comprehensive and deep” reforms
- Markets will play a “decisive” role and the role of government will shift more to regulation and social spending
- Spending responsibilities and revenues will be realigned between the central government and local governments
- GDP targets will be less emphasized but environment protection will assume more importance

A new mode of people-centered urbanization

- Rural land tenure will be modified to increase the scale of farming, make it easy for rural residents to leave the land, and share more from land value appreciation
- A property tax will be introduced to better match the revenue and spending of city governments
- There is also talk of introducing an inheritance tax
- The *hukou* system will be gradually disconnected from the public benefits accessible to urban residents

A new face of municipal governments?

- GDP will be less emphasized but environment assumes more importance as performance indicators
- Spending priority should shift to social spending
- They will access more revenue from property taxes and bond issuance
- But they will be more constrained in suppressing labor costs, lowering land and environment costs, and granting tax incentives

Rise to shape the world

- The renminbi is being internationalized
- China has led to create the Asian Infrastructure Investment Bank (AIIB) and other multilateral development banks
- Through long-term funding and exporting of technology, machines and infrastructure projects, China is leading to create shared economic prosperity in the developing Asia and other parts of the developing world

What would really make China a great power?

- The largest economy?
- The biggest military?
- Bribe other countries to praise and follow China?
- Respected or feared?
- People are content to stay inside, and foreigners are eager to visit, study there and even immigrate there?
- Erect insurmountable walls or let people, capital and ideas to flow freely across borders?

Xi Jinping's vision

- Keep the people tamed
- Iron fist of harsh laws
- Mobilize national resources for large undertakings
- Contain ethnic separatism
- A controllable market economy on the fringe
- Promote a Chinese cultural identity
- Social safety net
- Self improvement in governance
- Meritocracy
- Keep the military docile
- One country and two systems for HK and Macau
- Promote a global community of common interests and OBOR

Key points

- China needs to switch from the past exports-driven growth engine to a domestic consumption-driven growth engine, or to turn workers into consumers
- This switch necessitates another switch from party-centered governance to people-centered democracy
- Economically, resources should switch from flowing to the party to flowing to ordinary people in building a “real socialist” market economy
- Instead of bribing (poor) countries into a China-dominated alternative world order, China should merge into the current global order
- Instead of locking people and capital inside China through erecting all kinds of wall, China should become truly open with free trade and free movement of people and capital

Review questions

- What are the salient features of China's past growth model?
- What are the essential ingredients of the new growth model?
- What are the critical tasks for the new round of reform?