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ByInvitation

The growth challenge for China's new leadership team

The 20th National Party Congress will usher in a new team tasked with executing Xi Jinping's New Development Concept for the economy. They face a daunting task.

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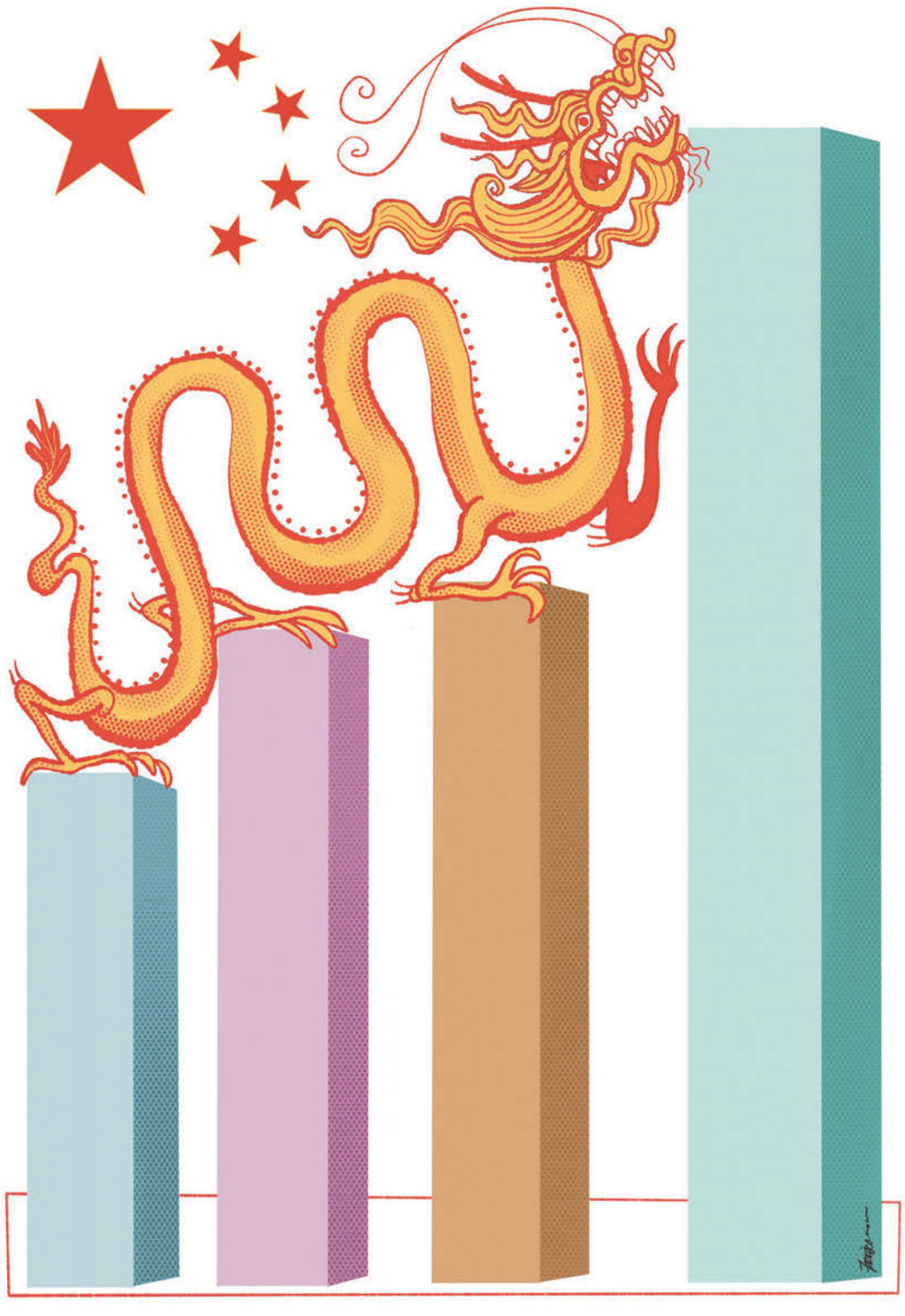
For The Straits Times



In the run-up to next month's 20th National Party Congress, a pall hangs over China's economic outlook. The most recent projections by the International Monetary Fund put China's GDP growth for the year at 3.3 per cent, 1.5 percentage points below its initial forecast; some private-sector forecasts now have dipped below 3 per cent.

There are several reasons for China's slowing growth. These include the unwinding of the property sector boom, which has been a major driver of growth in the past two decades. A push by the central government in 2020 to rein in the real estate sector has backfired – major developers have foundered, would-be buyers have stayed away for fear of being stranded with unfinished property. Dwindling land sale revenues for local governments has hampered an economic stimulus. Meanwhile, property prices have been falling for more than a year now, and have started to undermine consumer confidence, which is at the lowest point since 1991.

Covid-19 flare-ups in major cities and the lockdowns under China's "dynamic zero Covid-19" policy have also taken a heavy toll on the economy, the services sector in particular. The strict lockdown policy has not changed with rising vaccination, which is now at 90 per cent. Hopes that the policy may change soon after the 20th party congress are dwindling, with most observers expecting this to happen only some time next year.

China's "Common Prosperity" ideological objective has also dampened the investment climate. Though the policy announcements are light on actual policies to achieve it, many observers saw the regulatory crackdown on Internet-based enterprises as signs that the it constitutes a fundamental policy shift against the private sector. Though the authorities have repeatedly given the assurance that this was not the case, it has nevertheless slowed private investments in sectors well beyond tech.

On top of these domestic issues, the Russian invasion of Ukraine is adding to the uncertainty in the international environment and threatens to push advanced economies into a recession. This is affecting demand for China's exports, which until now has been the saving grace for the economy.

Low growth and the weakness of the renminbi – it has depreciated some 8.5 per cent against the US dollar since January – means that this year, China's gross domestic product in US dollar terms is likely to shrink – for the first time since the 1980s.

All these signs add up to a picture that is a far cry from that just two years go. Then, in the wake of China's rapid control of the first Covid-19 wave, some observers projected China to catch up with the United States before the decade was over. Now some analysts think this may never happen, and that China's growth could be stuck at 2-3 per cent for the foreseeable future. This would fall well short of the almost 5 per cent growth needed to meet President Xi Jinping's goal to double the 2020 GDP by 2035, the end of the first phase of his "New Era".

A short-term rebound in growth can be expected once China's Covid-19 policy is relaxed and the property sector may eventually stabilise as the government has already started providing support. But structural challenges remain.

China is facing a declining and ageing population in the decades ahead, which will turn the demographic dividend of the past into a tax on growth. Productivity growth, which was supposed to become the main driver, has been disappointingly low in the past decade as well. On the demand side, rebalancing from investment and export driven growth was to be replaced by more consumer demand. But today, consumer demand still only makes up less than 40 per cent of GDP, only 3 percentage points more than a decade ago. And investment and exports remain key for demand growth.

So is this the end of China's growth miracle?

Not necessarily. Much hinges on the direction of China's economic policy and its new slate of policymakers to be unveiled at next month's party congress.

REFORM PROGRAMME

An ambitious reform programme could still push China's potential growth above 5 per cent or so for the next 10-15 years.

Mr Xi 's first economic programme in 2013, decided at the 3rd Plenum of the 8th Central Committee, sought to boost growth through reforms that would, among other things, spur productivity, shift demand more to household consumption and provide better social security in order to drive down China's famously high household savings. Key in that programme was "the decisive role of the market in the allocation of production factors".

Though progress was made on that reform agenda, a new growth model has failed to emerge. There are various explanations for this.

One reason could be that Mr Xi was never really on board with the 2013 reform plans to begin with. Sceptics of the reforms saw the financial turbulence of 2015 as evidence of the failure of its market model, and he sought more control over the economy as a result.

Mr Xi's political agenda, including his ongoing anti-corruption drive and the restoration of party discipline, may have contributed as well. Local government officials, engines of growth and policy innovation in the past, became passive executors of the "top-down" policies declared by the centre and designed by various small leading groups and commissions under Mr Xi.

Another explanation is that interest groups that benefited from the existing model, such as state-owned enterprises, urban citizens and local government officials, put up effective resistance against the reforms. Even the crackdown on innovative sectors such as fintech, which provided heavy competition for incumbent banks, could be seen in this light.

A final explanation is that external circumstances have changed the priorities of China's leadership. From early on in his first term, Mr Xi has emphasised the importance of national security, which he put at the same level of importance as economic development. This gained prominence after the Trump administration's trade and tech war and the Biden administration's moves to address the China challenge through revamping alliances and doubling down on Trump-era policies.

By the time of the 19th Party Congress in 2017, the party had redefined its fundamental priorities (the "principal contradiction") altogether; the emphasis shifted from growth per se to "balanced growth". Since then, the Communist Party of China (CPC) has introduced new policy concepts to put meat on this new bone, including "common prosperity", "dual circulation" and "ecological civilisation", as well as a "community of a shared future for mankind" and a "global security initiative" for China's engagement with the rest of the world.

NEW DEVELOPMENT CONCEPT, NEW LEADERS

An October 2020 speech by Mr Xi published on Aug 30, 2022 in the CPC's flagship magazine Qiushi pulls it all together. Published under the tongue-twisting title, "The implementation of the New Development Concept in the New Development Stage will inevitably require the construction of a New Development Pattern", the speech contains some of the CPC's long-standing development thinking, including "reform and opening" and the "four modernisations".

What is new in the New Development Concept is the emphasis on self-reliance in technology and supply chains, on using the domestic market and domestic supply chains to counter the instability of the international economy and on security, as expressed in national security, food security, energy security and so on.

Missing in the speech was any reference to the "decisive role of the market in the allocation of production factors". The 2017 Party Constitution includes this very phrase. This Constitution, though, is set to change at the 20th Party Congress, and in all likelihood, the New Development Concept will make it to the new Constitution, perhaps even as a successor to reform and opening up.

Ideology aside, much of the future course of China's economy will depend on the people who will run the economic agenda. This is so not least because the concepts and priorities as expressed in party ideology are sometimes contradictory, and often in need of concrete policies to turn them into reality. This provides considerable discretion to the economic team.

China's economic team is about to change. Premier Li Keqiang, formally in charge of the economy, has already announced he will not serve beyond his term that ends with the next National People's Congress (China's Parliament) next March, though he may still play a prominent role in the party or in the National People's Congress.

Vice-Premier Liu He is now 70, well beyond retirement age and likely to be replaced, though again, he may continue to play a role in advising Mr Xi. And Mr Yi Gang, the governor of the central bank, will reach retirement age by March next year.

Speculation on the new leadership is rife in the run-up to the Party Congress. Possible candidates for top economic posts such as Cabinet secretary-general Xiao Jie, central bank party secretary Guo Shuqing, or Mr Wang Yang, chairman of the national committee of the CPPCC (Chinese People's Political Consultative Conference) are seen to be more technocratic. Close allies of Mr Xi, such as Mr He Lifeng, chairman of the National Development and Reform Commission, and director of CPC general office Ding Xuexiang are considered more statist. These two officials accompanied Mr Xi on his trip to the Shanghai Cooperation Organisation summit in Samarkand.

Following the CPC leadership gathering in coastal Beidaihe in August, a meeting where traditionally key decisions are made, President Xi and Premier Li set off for different parts of the country. Mr Xi visited China's north-east, the old industrial base dominated by state-owned enterprises. In contrast, Mr Li went south, visited Shenzhen and paid tribute to Deng Xiaoping at a statue in his honour. Ironically, this heart of China's capitalism was once led by the President's father Xi Zhongxun.

Despite these geographically opposite and symbolic destinations, there is no contest as to whose economic views will prevail at the 20th Party Congress. The question is whether the New Development philosophy can revive China's growth to a level that is consistent with the national rejuvenation Mr Xi seeks for his New Era.

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