

China policy overview



Associate Professor
Jane Golley



Associate Professor Jane Golley is an economist and Acting Director of the Australian Centre on China in the World (CIW) at The Australian National University (ANU). Her research over several decades has covered a wide range of Chinese transition and development issues, including industrial agglomeration and regional policy; demographic change and economic growth; rural-urban and gender inequalities; and the Belt and Road Initiative. Jane is actively engaged in public policy and media debate regarding the Australia-China relationship.

Contradictions, conundrums, contention and conflict

In 2018, China entered its 40th year since economic reforms and opening up commenced under Deng Xiaoping in 1978. During that period, the country's economic achievements have been phenomenal. With GDP increasing from 369 RMB in 1978 to 82.7 trillion in 2017, China has become the world's second largest economy, and is predicted by the International Monetary Fund (IMF) to be the world's largest by 2030.¹

An average annual GDP growth rate of 9.5 per cent has seen China's share in world GDP increase from 1.8 per cent to 15.2 per cent. Import and export volumes have risen from a paltry US\$20.6 billion to over US\$4 trillion, making China the world's largest trading economy, with the highest foreign exchange reserves, at US\$3.1 trillion in January 2019.² Hundreds of millions of Chinese people have been lifted out of poverty and, according to the Hurun Global Rich List 2018, 819 Chinese have become

billionaires – the highest number in the world, with the US coming a distant second, with 571.

These achievements gave Xi Jinping, President of the People's Republic of China, much cause for celebration in 2018. On 18 December 2018, President Xi marked the 40th anniversary with a speech reaffirming China's commitment to the path of economic reform and opening up to the outside world.³ Describing the reforms as a "great reawakening" of the Chinese Communist Party (CCP), he credited the Party with "the most profound and the greatest social transformation in Chinese history". He also stressed the need to adhere to his 'Four Confidences' – in following the path, theory, system and culture of Socialism with Chinese Characteristics – in order for China to achieve the "great rejuvenation of the Chinese nation".

Throughout 2018, however, it became increasingly clear that not everyone shares either Xi's confidence, nor his vision for China's future. Instead, the year abounded with contradictions, conundrums, contention and conflict – a very different Four Cs to the ones espoused by Xi.

These were evident in the ongoing slowdown of the Chinese economy, the extent of which, alongside the causes and appropriate policy responses, remain highly contested. There was growing international criticism of Xi's two signature policies – the Belt and Road Initiative, the centre piece of his foreign policy, and Made in China 2025, the crux of his domestic industrial policies. On top of all this was the most significant conflict of all, the US-China trade war, which escalated throughout the year. Viewed in this context, as 2019 commences, it is difficult to have confidence in anything much at all.

Socialism with Chinese characteristics

In 2013, shortly after rising to power, Xi signalled his serious commitment to embarking on wide-ranging reforms to rebalance the economy and to “redefine the relationship between government and market”, with the market being assigned a “decisive role”. While this led to great (albeit unrealistic) expectations at the time that the state was finally going to retreat and the market would thrive, this had clearly not materialised by 2018.⁴

Instead, the National Party Congress (NPC) in March formally recommended that Xi Jinping's “Thought for the New Era on Socialism with Chinese characteristics” be written into the constitution, along with a clause rescinding the two-term limit on the PRC presidency, effectively giving Xi life-long rule should he choose it. This epitomises the centralisation of power that Xi has pursued during his first six years in office, with his tightening grip being evident across the party, government, military, economy and

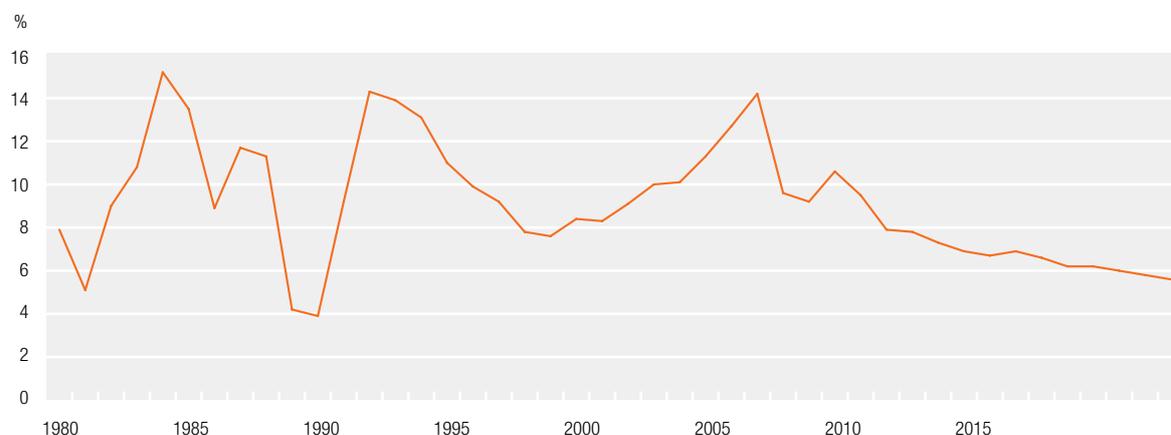
civil society. These changes all seem to contradict Xi's ongoing claims that he remains committed to reforming the economy (a process that remains far from complete 40 years into the transition), and that China is an economy based on openness, transparency and mutually-beneficial free trade.

These changes have generated growing anxiety across the globe, and in the West in particular, about how China's wealth and power are challenging the global status quo and the rules-based order that has been defined and led for more than half a century by the US – until the election of President Donald Trump in late 2016. Internally, a number of Chinese academics are expressing their concerns about China's future path as well, despite growing efforts by the state to curb academic freedoms and ensure that the party line is adhered to by all.⁵

Slowing growth, growing debt

In 2018, real GDP growth continued on its downward trend (Figure 1), although the extent of that trend remains hotly debated. China's National Bureau of Statistics confirmed in January 2019 that the government's official target of 6.5 per cent will be met – as it has consistently confirmed about all its official targets in the past. The starkest contrast with this reported figure came from Renmin University professor Xiang Songzuo, who gave a speech in December 2018 (soon after blocked from the Chinese internet), claiming that a secret government research group had estimated GDP growth at 1.7 per cent for the year.⁶

FIGURE 1
Official real GDP growth of China, annual per cent change, 1980–2018



Source: IMF World Economic Outlook.

“The true growth rate for 2018 will likely never be known by anyone.”



In contrast, according to Professor Yiping Huang of Peking University, even if the official growth rate of 6.5 per cent is overestimated, the ‘Li Keqiang index’ (attributed to Chinese Premier Li Keqiang and based on indicators like electricity output and freight volumes that are less vulnerable to manipulation) still indicate a growth rate of “six per cent or slightly below”.⁷ The true growth rate for 2018 will likely never be known by anyone.

Regardless of the precise figures, there was broad consensus that the growth slowdown in 2018 could be attributed to a number of factors. Following an infrastructure boom in 2016–17, a toughening stance on local government borrowing resulted in a sharp slowdown in credit flows, with the most dramatic impact on growth in infrastructure investment, which plummeted from 19.8 per cent in 2017 to just 3.3 per cent in the first three quarters of 2018 (year-on-year).

Consumption growth also slowed through 2018, underpinned by falling consumer confidence, along with retail sales and industrial output. Export growth also began to slow as the trade war with the US intensified, and despite a depreciating RMB, from a peak of 15.4 per cent in February (year-on-year) to a low of 5.4 per cent (year-on-year) in November.

While slowing Chinese growth was met with despair in the international media,⁸ growth rates over six per cent are still very impressive, and consistent with the government’s strategy over the last decade

to rebalance growth towards the domestic economy (and away from the investment- and export-led growth strategy of the past), and to achieve ‘new normal’ rates of growth (of between six and seven per cent). The slowdown also reflects the transition towards higher value-added industries in the context of an ageing population and rising wages, and the relatively austere macro policies since 2016, attempting to mitigate the growing debt risks. Stricter enforcement of environmental regulations has also contributed to a slowdown in economic activity, but is consistent with the drive towards greener, more sustainable and high quality growth.

But the risks for even slower growth are real and rising, with debt posing one of the most significant threats to China’s growth prospects in 2019 and beyond. Corporate sector debt has stabilised since 2016, but remains worryingly high (according to the IMF, at around 135 per cent of GDP by the end of 2017). Government and household debt have risen steadily since 2014, reaching close to 135 per cent and 125 per cent by the end of 2017. According to S&P Global Ratings, the country’s total non-financial sector debt, which includes household, corporate and government debt, could rise from 242 per cent in 2016 to close to 300 per cent of GDP by 2022.

They estimate off-balance-sheet debt in Chinese local governments as high as RMB 40 trillion (US\$6 trillion): a debt iceberg with titanic credit risks.⁹ Although the precise figures remain highly

contentious,¹⁰ few would disagree with Xiang Songzuo's assessment that China's current financial risks are "hidden, complex, acute, contagious, and malevolent. Structure imbalances are massive, and violations of law are rampant."¹¹

Many analysts fear that the Chinese government will attempt to counteract slowing growth with expansionary monetary and fiscal policies that will exacerbate the debt problem in 2019. The People's Bank of China's pledge to reduce the reserve requirement ratio by one percentage point in January 2019 (giving the banks leeway to lend an additional RMB1.5 trillion, or US\$218 billion) and a substantial boost to spending on high-speed rail infrastructure (with the state-owned China Railway Corporation planning to expand track by 6800 kilometres in 2019, up 45 per cent from the expansion in 2018) are two early indications that these fears may be valid.¹² The appropriate mix of macroeconomic policies to steer China's economy through what is likely to be a turbulent year will remain hotly contested.

The Belt and Road Initiative

First announced as the One-Belt-One-Road (OBOR) Initiative in 2013, the renamed Belt and Road Initiative (BRI) continued to expand in 2018, encompassing 68 countries that cover the entire Eurasian zone. The

initiative calls for a multi-dimensional infrastructure network, which will include a number of economic corridors (including the China Pakistan Economic Corridor, China Mongolia Russia Economic Corridor and the New Eurasian Continental Bridge), combining land, sea and air transportation routes with major railway, port and pipeline projects. The initiative will also create mechanisms for policy dialogue, infrastructure connectivity, tariff reductions, financial support and people-to-people exchange across the participating BRI countries – the so-called Five Connectivities.

With the BRI now written into the Chinese constitution, there is no question that it will remain a key policy priority in 2019, and well beyond that. But significant questions remain over the motivations, outcomes and impacts of the initiative, with little agreement on any of these – including the projected value of BRI projects, which begin at around US\$1 trillion, but with one estimate going as high as US\$8 trillion.¹³

China's official stance is that the BRI offers the world a mutually beneficial win-win opportunity to engage in free trade and promote prosperity for all. This contrasts with fears expressed in Western newspapers that BRI-recipient countries will become saddled with rising and unsustainable levels of debt, which will enable China to extend its political influence and power in undesirable ways – in what has become known as debt-trap diplomacy.



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While recent scholarly evidence has discredited the debt-trap diplomacy thesis,¹⁴ it has fuelled mistrust in the BRI in many countries across the Asian region. In June 2018, former Foreign Minister Julie Bishop declared that Australia (which has declined to formally align with the BRI, with the exception of Victoria) will compete with China’s infrastructure projects in the Pacific to offset China’s greater political and strategic influence in the region, and to ensure that unsustainable debt burdens are not imposed on Pacific nations.¹⁵

The 2018 election loss of former Malaysian prime minister Najib Razak was at least in part because of accusations that he was selling out the country to China. Newly elected Prime Minister Mahatir Mohammad has pledged to review all Chinese projects and renegotiate any unequal treaties.¹⁶

Closer to China’s borders, Japan signalled a shift towards greater cooperation with China, following a meeting between Prime Minister Shinzo Abe and Chinese Premier Li Keqiang in June, at which they agreed to establish a joint committee to coordinate economic cooperation in third countries – a remarkable shift given the tensions that have dominated this bilateral relationship in the past.¹⁷ Other regional responses have varied from all-embracing and friendly ones, as in Kazakhstan and Pakistan, to extreme wariness, as in India, with many countries

– like Russia, Japan and Malaysia – changing their stance over time. This makes it very difficult to predict how the BRI will evolve in the year ahead, short of noting that it won’t be straightforward.

Trade and technology tensions

The trade war between the US and China began in earnest on 22 January 2018 with the US imposing tariffs worth US\$8.5 billion on imported solar panels and US\$1.8 billion on washing machines. By March, Trump had authorised tariffs of 25 per cent and 10 per cent on steel and aluminum, and by 1 April, the PRC began retaliating with tariffs affecting US\$3 billion of American goods. And on it went, with US tariffs on Chinese imports skyrocketing to US\$200 billion by September, when China’s retaliatory tariffs on US imports reached US\$60 billion. The 90-day truce reached by the leaders of the two superpowers in Buenos Aires in December amounted to an agreement to halt further escalation of tariffs, with negotiations on the final deal due to be completed in March 2019. Whatever that final deal is, trade tensions between the world’s two largest economies are unlikely to fade away, and the global economy will suffer as a result.

In conjunction with increasingly higher tariffs, the Trump Administration also tightened technology controls on China throughout 2018, prompting former US Treasury Secretary Hank Paulson to warn of a looming Economic iron curtain between the US and China.¹⁸

One major source of tension is China's Made in China 2025 (MIC2025) program, which prioritises 10 high-tech sectors including space and aviation, maritime equipment and high-tech ships, high-end computerised machines and robots, and energy



“MIC2025 aims to make China one of the world’s most innovative countries by 2020, and a leading global science and technology power by 2049.”



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In Europe, Canada and Australia, China’s technological collaborators became increasingly cautious of its rapidly growing technological capability – and use of industrial policy to achieve its goals – with worries about industrial espionage and forced technology transfers dominating media headlines in 2018.¹⁹ The Trump Administration even considered banning Chinese students from US universities, although has taken only more limited measures, including shortening the visa duration for Chinese students studying in some high-tech fields. As Andrew Kennedy puts it:

“What is clear is that China can no longer count on the level of international exchange and collaboration it has enjoyed in the technology sphere in the past. China’s rise as a technopower will continue, but Beijing could well find it a lonelier ascent in the future.”²⁰

This is not where China would have expected to find itself after 40 years of economic reforms and opening up.

Conclusion

While these first 40 years could broadly be considered as providing win-win opportunities for the vast majority of Chinese citizens – and substantial economic benefits for much of the rest of the world as well – the future seems far more likely to be characterised by the issues that have plagued China throughout 2018. The number one contradiction will continue to centre on whether the market will be given an increasingly decisive role or whether, as current trends suggest, economic activity will be encroached upon by an increasingly authoritarian and controlling state.

Conundrums and contentions will remain over how best to respond to slowing economic growth and growing debt. And there will continue to be conflict between China and the rest of the world, and most of all with the US, as they grapple with how to respond to an increasingly powerful and rising China, with Xi Jinping at the helm in his new era of Socialism with Chinese Characteristics. It is hard to have confidence in much at all in this context, except to know that the years ahead will be plagued with uncertainty.

Endnotes

- 1 See 'China's Economic outlook in six charts', *IMF News*, 26 July 2018, Accessed from: <https://www.imf.org/en/News/Articles/2018/07/25/na072618-chinas-economic-outlook-in-six-charts>
- 2 Xi Jinping, Speech on 40th anniversary of China's reforms, 18 December 2018, Accessed from: <https://www.transcend.org/tms/2018/12/xi-jinpings-speech-on-40th-anniversary-of-chinas-reforms-opening-up-full-text/>
- 3 See 'China's Economic outlook in six charts', *IMF News*, 26 July 2018.
- 4 For a fuller discussion of this point see Golley, J. (2014). 'Great Expectations', in Geremie Barmé with Linda Jaiwin and Jeremy Goldkorn (eds). *China Story Yearbook 2014: Civilising China*, Canberra: Australian Centre on China in the World, Accessed from: <https://www.thechinastory.org/yearbooks/yearbook-2014/chapter-1-great-expectations/>
- 5 For two scathing examples, see Xiang Songzuo, 'A great unseen shift over the last forty years', 28 December 2018. Accessed from: <https://chinachange.org/2018/12/28/a-great-shift-unseen-over-the-last-forty-years/> and the series of speeches given by Xu Zhongrun, translated by Geremie Barmé. Accessed from: <http://chinaheritage.net/journal/imminent-fears-immediate-hopes-a-beijing-jeremiad/>
- 6 See Xiang Songzuo (2018) 'A great unseen shift over the last forty years', 28 December 2018. Accessed from: <https://chinachange.org/2018/12/28/a-great-shift-unseen-over-the-last-forty-years/>
- 7 Wildau, G., and Fleming, S. (2019). 'Nervous markets: how vulnerable is China's economy?', *Financial Times* 5 January 2019. Accessed from: <https://www.ft.com/content/5839f5dc-0fdd-11e9-a3aa-118c761d2745>
- 8 In January 2019, these headlines included: 'Nervous markets: how vulnerable is China's economy?' 'The future might not belong to China', 'Xi Jinping begins his most important year at his weakest point', 'Beijing dithers as the economy declines', and 'China's faltering economy gives US stronger hand in trade talks, says Trump'.
- 9 Reported by Martin, W. (2018). 'China's hidden \$6 trillion debt pile is an 'iceberg' posing a 'titanic risk'', 17 October 2018. Accessed from: <https://www.businessinsider.com.au/china-debt-crisis-6-trillion-off-balance-sheet-debt-poses-titanic-risk-2018-10>.
- 10 For example, while the National Audit Office puts local debt at around 17.8 trillion RMB, a vice-director of the National People's Congress Financial and Economic Affairs Committee concurs with S&P that it is likely over 40 trillion. The true figures, like China's GDP growth rates, may well never be known.
- 11 See Xiang Songzuo (2018)., 'A great unseen shift over the last forty years', 28 December 2018.
- 12 This expansion is more than the total amount of track laid in Spain, the world's second-largest high-speed rail network with a total of 3,100km. Tang, F. (2019) 'Full speed ahead for China's high-speed rail network 2019 in bid to boost slowing economy.' *South China Morning Post* 10 January 2019. Accessed from: <https://www.scmp.com/economy/china-economy/article/2180562/full-speed-ahead-chinas-high-speed-rail-network-2019-bid-boost>
- 13 See Hurley, J., Morris, S. and Portelance, G. (2018). 'Examining the debt implications of the Belt and Road Initiative', *Center for Global Development (CGD) Policy Paper* 121, March 2018. Accessed from: <https://www.cgdev.org/sites/default/files/examining-debt-implications-belt-and-road-initiative-policy-perspective.pdf>
- 14 Rohan Fox and Matthew Dornan examine the levels of debt distress in 15 Pacific Island countries, finding that just six faced high levels of debt distress, and only one of those six – Tonga – possibly gave some basis to the 'debt-trap diplomacy' thesis, and even then, they are emphatic that it was not the Chinese government that had driven the poor loans but the Tongans themselves. This echoed the findings of another important report published in March by the Centre for Global Development (based in Washington DC), which found that of the 68 BRI recipient countries, only eight (Djibouti, Kyrgyz Republic, Lao, Maldives, Mongolia, Montenegro, Pakistan and Tajikistan) were in the category of being 'highly vulnerable' to BRI-related debt distress. For further details see Fox, R., and Dornan, J. (2018) 'China in the Pacific: is China engaged in debt-trap diplomacy?', 8 November 2018. Accessed from: <http://www.devpolicy.org/is-china-engaged-in-debt-trap-diplomacy-20181108/> and Hurley, J., Morris, S. and Portelance, G. (2018) 'Examining the debt implications of the Belt and Road Initiative', *Center for Global Development (CGD) Policy Paper* 121, March 2018.
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- 16 Bland, B. (2018). 'China's south-east Asia threatened by new Malaysia regime', *Financial Times*, 15 May 2018. Accessed from: <https://www.ft.com/content/94906ad4-57eb-11e8-bdb7-f6677d2e1ce8>
- 17 'Government seeking involvement in China's Belt and Road plans', *The Japan News*, 18 June 2018. Accessed from: <http://the-japan-news.com/news/article/0004520406>
- 18 'Paulson warns of economic iron curtain between US and China', *Bloomberg News*, 7 November 2018. Accessed from: Online at: <https://www.bloomberg.com/news/articles/2018-11-07/paulson-warns-of-economic-iron-curtain-between-u-s-china>
- 19 See Andrew Kennedy's (forthcoming) chapter in *China Story Yearbook 2018: Power*, due out in April 2018 (and available online for free download).
- 20 See Andrew Kennedy's (forthcoming) chapter in *China Story Yearbook 2018: Power*, due out in April 2018 (and available online for free download).