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READING CHINA'S REFORMS ONE YEAR ON

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One year ago, China's leaders announced a sweeping economic reform package aimed at rebalancing growth in the world's second-largest economy. **Estimates suggest** that, if implemented, these reforms could propel another doubling in the size of the Chinese economy over the next decade. Failure to follow through, however, could see annual GDP growth rates **fall below 1 percent by 2020.** As discussed in an earlier **Simon Chair report**, big questions remain about how Beijing will implement the proposed reforms. The first year of the process has seen Chinese leadership attempting to aggressively reshape an unwieldy economic policymaking apparatus to suit new needs. The results give cause for optimism, but not complacency: Beijing's path toward making **"meaningful progress"** on reform by 2020 remains littered with obstacles, and the risks of the current strategy are becoming apparent.

Upcoming Events

- November 27: Thanksgiving Day (U.S.)
- December 1: International Programs of the U.S. Treasury (CSIS)
- December 8: Smart Women, Smart Power (CSIS)
- December 14: Lower House Elections (Japan)

Upon coming into office, President Xi Jinping and his colleagues on the Politburo Standing Committee inherited a credibility problem. Market reforms had stalled under the previous leadership's decade in power, and the limits of China's investment-led growth model were apparent. Through what has been described as the **economic equivalent of "shock and awe,"** the Third Plenum shattered this narrative. **Analysts lauded** as "potentially revolutionary" the breadth of the reforms; Xi's decision to personally brand the agenda; the establishment of new, top-level policy coordinating bodies (of which Xi named himself head); and the commitment to give markets a "decisive role in resource allocation." While initial euphoria over the reform agenda has faded, Xi's consolidation of power has left little doubt he intends to lead more decisively than any Chinese leader since Deng Xiaoping.

Despite this, Xi's command over the levers of political power has yet to translate into a clear set of priorities for economic reform. In this sense, the comprehensiveness of the Third Plenum decision—336 measures spread across 60 articles—is also a weakness. Clear priorities are essential to coordinating China's fractious economic policymaking apparatus and ensuring that in areas where sequencing is paramount, such as financial reform, measures are introduced in a logical order.

On paper, this was one motivating factor behind the establishment of the new "leading small group" tasked with overseeing the reform process. Yet instead of lending coherence, Xi's efforts to personally oversee the reform agenda and his reliance on a small group of policy advisers have arguably disrupted established bureaucratic communication channels and, at least for the time being, worsened coordination. Should this trend persist, it could slow the implementation of reforms at a moment where the economic costs of delay are rising.

The breadth of the Third Plenum agenda has also influenced relations between the central and local governments. Since Deng Xiaoping's "reform and opening," Beijing has governed in part by setting policy targets for local leaders and relying on their initiative to generate results. Pledges from Xi and Premier Li Keqiang to **pursue "top-level design" of reform** signaled a desire to pursue greater coherence in policy implementation by reining in these same local officials. Simultaneously, Beijing has reemphasized the importance of **"crossing the river by feeling the stones"** and adapting policy to suit local circumstances.

Creation of an estimated 800 local reform groups organized under the main Beijing body should thus be read as an effort to establish not only greater coordination, but a new conveyor belt for ideas to flow between local leaders and central policymakers. This could facilitate a dynamic interaction between central and local governments that produces a reform effort both national in scope and tailored to meet local needs. However, this will be a delicate balance to strike; it could instead generate an overly prescriptive and piecemeal approach that inhibits the productivity gains market reforms aim to facilitate.

READING CHINA'S REFORMS ONE YEAR ON *(continued)*

Another shift evident under Xi is a more cautious approach to the use of policy experimentation. China has long used geographically contained pilots to test reforms, thereby creating support for expanding measures that succeed and limiting fallout from those that fail. In the most high-profile pilot introduced under Xi thus far, the Shanghai Free Trade Zone (FTZ), a more incremental approach appears evident. Initially billed as a testing ground for financial reform, the substantive reforms introduced after a year of effort have been modest. Instead, the Zone has mainly served as a pilot for administrative reforms, such as easing requirements for new business registration and piloting a "negative list" approach to foreign direct investment.

To some extent, an incremental approach is warranted: particularly in the area of financial reform, history is replete with examples of rapid liberalization creating conditions for a crisis. However, there is also hazard in caution at a time when latent risks are building. Another potential difficulty is that incremental experiments that take too long to show signs of success may be judged as failures, becoming political obstacles for reformers.

The course the Shanghai FTZ has taken so far is also revealing of another evolving characteristic of economic policymaking: how China responds to international pressure. Washington has long encouraged Beijing to accelerate its financial liberalization efforts. Successive generations of Chinese leaders have largely ignored this bilateral pressure, except when Washington's suggestions aligned with their objective of maintaining domestic economic stability. While the Xi administration is no exception to this pattern, international pressure has influenced the Shanghai FTZ experiment. According to senior Chinese policy advisers, the initiative was in part a response to developments in the Trans-Pacific Partnership negotiations, notably Japan's decision to join in April 2013. Tokyo's entry provided critical impetus behind Beijing's decision to reengage Washington on negotiations over a U.S.-China bilateral investment treaty several months later and to pilot in the Shanghai FTZ many of the reforms that would be required in any eventual deal.

Reviewing the emerging strategy of reform implementation under Xi, two risks are apparent. The first is that limited pilots and a piecemeal approach to implementation fail to show the desired results and complicate the already difficult politics of reform. The second, and perhaps more worrying possibility, is that Beijing's gradualist approach is overtaken by events. It is widely agreed that Chinese leaders **have the tools available to avoid a true financial meltdown,** from experienced technocrats to enormous foreign exchange reserves. Beijing has also historically done an impressive job of economic crisis management. However, past performance may not be a good guide to future success. When the last major reform push ended a decade ago, the economy was a quarter its current size and still had the option of exporting and overinvesting its way to growth. Today China's economy is orders of magnitude more complex. The challenges of reform—and crisis management—will be as well. ■

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Simon Says…

Worried about whether China can transition toward a future of consumption-led growth? November 11 (11/11) is Singles' Day in China, an occasion for the unattached to celebrate—and commiserate—their single status. Alibaba has successfully transformed the holiday into an online shopping carnival. According to the official release from Alibaba, the online platform generated 1 billion renminbi (RMB) in sales in less than three minutes. Total sales for this year's Singles' Day amounted to 57.1 billion RMB ($9.3 billion), higher than the sum of Black Friday and Cyber Monday sales in the United States in 2013.

Those prone to overspending on Singles' Day are often advised "you should cut your hands off before you buy more." Perhaps taking the phrase too literally, the wife of a Chinese professional shooter (and semi-professional spendthrift) accordingly tied her husband's hands to prevent him from buying online. Her efforts were to no avail: the determined athlete still managed to spend over 20,000 RMB ($3,000) using only his right foot. The picture of him **clicking a mouse with his toes** above the caption, "Honey, you are too naïve!" has since been widely circulated on popular Chinese microblogging site Weibo. ■