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NAVIGATING CHINA'S ECONOMIC RAPIDS

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The Chinese economy is off to a bumpy start in 2015. The International Monetary Fund is projecting real growth of 6.8 percent this year, the slowest in a quarter century. **Recent data releases** have highlighted weakness in a number of key areas of the economy, from retail sales to industrial output. Meanwhile, the prospect of a Fed rate rise later this year has put the People's Bank of China **in a bind**, as it seeks both to cushion a deepening slowdown and to guard against potentially damaging capital outflows. This has intensified the debate over whether President Xi Jinping and his team of economic decisionmakers have the "right stuff" to manage a stable transition to a new model of economic growth. The Simon Chair has recently completed a two-year study of this question and will **release its findings** on March 31. Our assessment is that, while the odds favor China's economic navigators, **it is clear the economy is entering choppy waters.**

No one—including China's leadership—disputes the fact that the country faces a daunting array of challenges in its quest for **"national rejuvenation."** Beijing's reform checklist includes shifting the drivers of growth from investment and industry to consumption and services; reforming a corrupt and cumbersome governance apparatus; curbing severe air, soil, and water pollution; and addressing rampant domestic inequality. The new challenge for the current leadership is pursuing this expansive agenda in the context of a political economy that is far more pluralized than before. Not only are there multiple policy objectives beyond growth alone, but an increasing array of interest groups, from bureaucrats and state-owned firms to civil society and private enterprise, are competing to see their priorities met.

Two years ago, it was hard to imagine President Xi facing down these difficulties, given a **battered elite consensus**, a corrupt and faction-riven party, and a gridlocked state bureaucracy. Most observers expected that it would take years before Xi would be able to put his distinctive stamp on policy. Yet he has since turned much of this narrative on its head, engineering a dramatic restructuring of China's economic policymaking apparatus to place himself at its apex. In November 2013, even as he personally endorsed a sweeping reform agenda at the Communist Party's Third Plenum, Xi unveiled the creation of a new "leading small group" that has since become the command center for overhauling China's economic and governance system. Over the past year, this Comprehensively Deepening Reform Leading Small Group has endorsed a variety of key measures, ranging from a sweeping fiscal reform plan to an important new system of property rights for agricultural land.

Coupled with a fierce anticorruption campaign, Xi's assumption of the key levers of economic policymaking has revealed a keen sense of political stagecraft and a rapid, opaque, and personalized decisionmaking style. These elements of Xi's approach to economic policymaking have important implications for his reform agenda, which we explore in greater depth in our **forthcoming report**. We assess that, on balance, Xi's efforts have improved the prospects for China's making a stable transition to a new model of economic growth, but they also carry clear risks.

On the asset side of the balance sheet, Xi's personal decisionmaking and heavy use of party institutions have allowed him to sidestep bureaucratic gridlock, empower a trusted and talented team of technocrats, and reassert the Communist Party's control over the policymaking process. In crucial areas such as fiscal and financial reform, Xi showed an early and unexpected willingness to support key ministries in cracking down on bad behavior by local officials and state-owned enterprises. The breadth of the Third Plenum reforms illustrates that Xi and his advisers understand the interrelatedness between seemingly disparate policy issues, such as anticorruption and state-owned enterprise reforms. In this, and in his use of external pressure—as illustrated by the impact of the Trans-Pacific Partnership on the Shanghai Free Trade Zone—



Upcoming Events

- March 26 – 29: Boao Forum (China)
- **March 31: Navigating Choppy Waters: Economic Decisionmaking at a Time of Transition (CSIS)**
- **April 10: Financing Growth in the Asia Pacific (CSIS)**
- April 12 and 26: Local Elections (Japan)

NAVIGATING CHINA'S ECONOMIC RAPIDS *(continued)*

to help organize and push his agenda, Xi is also clearly borrowing from the playbook used in earlier successful reform drives, such as the one orchestrated by Premier Zhu Rongji in the 1990s.

In other ways, Xi's approach entails significant risks that could undermine China's transition toward a **"modern, harmonious, creative, and high-income society."** Empowering the Communist Party at the expense of the state runs counter to earlier reform drives, including that overseen by Zhu, and reinforces a tendency toward secrecy, unpredictability, and heavy-handed controls that sit uncomfortably alongside Beijing's goal of transitioning toward a more market-based economic and financial system. Previous leaderships' emphasis on consensus-based decisionmaking was an impediment to rapid change, but also an effective tool for gaining buy-in from the bureaucracy and troubleshooting proposed policy measures. Xi's more rapid and less consultative approach may generate serious unintended consequences. His emphasis on anticorruption has, **according to some accounts**, done exactly this, producing near paralysis in local decisionmaking and dampening growth in the short term. Moreover, the current drive to reassert central control and limit local policy experimentation could undermine one of the **enduring characteristics** of Chinese economic policymaking that has been critical to its success.

However, the central risk lies in how Xi's agenda beyond the economic realm will impact China's economic performance. Even as he is pursuing reform and opening as a means of achieving national rejuvenation, a countervailing impulse toward retrenchment and restriction is evident, from efforts to purge "Western values" to measures

aimed at "indigenizing" China's information technology infrastructure. These are not only making China's **relations with trading partners more contentious**, but could also have **negative consequences** for future innovation, productivity growth, and China's ability to generate unique intellectual property. There remains an unresolved tension between Xi's grasp for greater political control, on the one hand, and the imperative of letting go economically on the other.

As our report emphasizes, this does not mean it is time to count China out. Successive generations of Chinese leaders have proven themselves pragmatic and capable politicians, adapting well to changing circumstances over the course of China's decades-long economic miracle. Xi has already gotten off to a faster-than-expected start, and there is a **serious argument to be made** that major structural reform is already underway. 2015 could turn out to be the breakout year for reform that many hope it will be—and that China needs before political wrangling begins in advance of the 2017 leadership transition. However, the economic challenges China faces today are qualitatively different from those of the past, and getting to the next stage of development will undoubtedly be more difficult. Xi Jinping may have a firm hand on the economic tiller, but China is clearly in a narrower, more treacherous part of the river. ■

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Simon Says...

Xi Jinping is certainly getting more individual coverage than many of his predecessors. According to different sources, he is the most important leader since **Deng Xiaoping**, **Mao Zedong**, or even **Han Emperor Xuan** (91–49 BC). Simon has some sympathy for China's over-worked censors, who have their hands full trying to tone down praise and criticism equally. **In March**, China's censors went after a New York Times article on the explosion in adoration of Xi, while three months earlier they had to **defend the chairman's waistline** following a critical letter from an elementary school student.

More often, the work of the censors is trying to determine when praise is criticism in disguise. To that end, Xi's famous steamed bun lunch in December of 2013 has been the **gift that keeps on giving**. For that incident, Xi became known to netizens as the "Steamed Bun Emperor," and in an illustration of just how richly complicated Chinese puns can get, censors are now blocking **certain imperial references** on Weibo. According to China Digital Times, the terms "Qingfeng Emperor" (a reference to the steamed bun shop) and the first three years of "Qingfeng's reign" are both blocked. ■