

AUSTRALIA-CHINA AGENDA 2013

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China's Great 'Rebalancing' Act

JANE GOLLEY

Jane Golley is an Associate Director of the Australian Centre on China in the World, ANU. After studying economics and Japanese at the ANU, she joined the Asia Section of the Australian Commonwealth Treasury, before spending eight years in Oxford completing her MPhil and DPhil and teaching undergraduate economics. She returned to the ANU in 2003, and has since published research on a wide range of Chinese development issues relating to industrial agglomeration and regional policy, demographic change and economic growth, rural-urban inequalities in education, urban household consumption and carbon dioxide emissions, 'green' productivity growth, and 'Socialism with Chinese Characteristics'.

THE AUSTRALIAN Centre on China in the World engages with the public and policy discussion of relations with the People's Republic of China and the Chinese world. Australia-China Agenda 2013 is our contribution to this important election year and the on-going consideration of the bilateral relationship.

This is a relationship that touches on virtually every aspect of our national life. A mature and beneficial engagement of such breadth and depth requires the leadership and support of government at all levels, as well as public stewardship, media understanding, educational enhancement and the strategic involvement of the business community.

Australia-China exchanges are also profoundly influenced by regional and bilateral relationships. Australia and China trade in goods as well as culture, politics and people, ideas and education, community and personalities.

Australia-China Agenda: 2013 brings to the attention of the public and the media, politicians and specialists some reflections and policy ideas authored by specialists with a professional interest and involvement in the relationship.

—Geremie R. Barmé
Founding Director, CIW

JANUARY 一月

FEBRUARY 二月

MARCH 三月

APRIL 四月

MAY 五月

JUNE 六月

JULY 七月

AUGUST 八月

SEPTEMBER 九月

OCTOBER 十月

NOVEMBER 十一月

DECEMBER 十二月

二〇一四年

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CHINA'S ECONOMIC model has delivered phenomenal rates of growth over the last three decades, resulting in the country's rise to front and centre of the global economic stage. However, it has also been highly imbalanced: favouring exports and investment over domestic consumption, capital over labour, east over west, urban over rural, state-owned enterprises (SOEs) over the private sector, and economic growth over the environment. The growing dissatisfaction of 'ordinary' Chinese people over these imbalances, most of which relate to the concentration of wealth in the hands of politically-connected families and the state-controlled segment of the economy, is one of the biggest threats to social and political stability that the Chinese Communist Party (CCP) has faced in its history.

The CCP is well aware of this fact. The 'rebalancing' of the Chinese economy emerged as a fundamental policy goal in the mid-2000s, and will continue to dominate economic policymaking under President Xi Jinping and Premier Li Keqiang. Until recently, rebalancing focused primarily on the shift away from capital-intensive, export-led growth and towards domestic consumption as a key driver of growth. However, the concept now extends well beyond this, encapsulating the wide-ranging set of reforms – to modes of production, consumption, and income distribution – that many believe are both urgent and necessary for sustainable growth in the years ahead.

Background

The pursuit of balanced economic development has always been a cornerstone of CCP rhetoric. Shortly after rising to power in 1949, Mao Zedong claimed that foreign domination had resulted in an 'irrational' pattern of industrial development that was excessively concentrated in the coastal region. During the subsequent three decades, China adopted a Soviet-style command planning system, through which an Interior Development Strategy explicitly sought to rectify this regional imbalance. Following Mao's death in 1976, and under the new leadership of Deng Xiaoping, the Chinese government began to recognise more openly the limitations and failures of command planning, of which the Interior Development Strategy was one. From the end of the 1970s through to the turn of the millennium, a process of gradual, incremental and piecemeal reforms focused primarily on encouraging efficiency and rapid growth in the more developed coastal region, with Deng famously declaring that some regions and people in China would need to become prosperous before others. And they did.

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Throughout his life, Deng made it clear that China was not on the path towards capitalism but was rather transitioning towards 'Socialism with Chinese Characteristics', which he defined according to the principles of single-party rule, a dominant role for state ownership, public ownership of the land, and state economic planning. He was

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also adamant that all Chinese people would prosper eventually and that there would be 'no polarisation of rich and poor, that's what socialism means'. Deng 'predicted' that the turn of the millennium would be the appropriate time to do something about the unbalanced economic growth that his reforms had created. Right on cue, President Jiang Zemin introduced the Western Development Strategy in 2000, identifying the large-scale development of central and western China as a major policy priority for the new century. The commitment to rebalancing, in a geographic sense at least, began.

Soon after taking over the top leadership position in 2003, President Hu Jintao took the notion of balance to a new level with his 'Scientific Outlook on Development', which called for balance not only between regions, but also between urban and rural areas, economic and social development, man and nature, domestic and international priorities, personal and collective needs, and the short and long runs. Despite this rhetoric, which culminated in the strong emphasis on rebalancing in the Twelfth Five-Year Plan (2011-2015), the Hu-Wen decade saw rising imbalances on all these fronts. Indeed, in his final report to the National People's Congress in March 2013, Premier Wen Jiabao reiterated a point he'd been making for many years, that China's domestic economy was 'unstable, unbalanced, uncoordinated and ultimately unsustainable'.

As outgoing Premier Wen was declaring the 'urgent need' for a new model of economic growth, outgoing President Hu Jintao was emphasising that 'the path of Socialism with Chinese Characteristics, the system of theories of Socialism with Chinese Characteristics and the Socialist system with Chinese Characteristics are the fundamental accomplishments of the Party and people in the course of arduous struggle over the past ninety-plus years'. Xi Jinping has made no indication that he intends to deviate from this Party line, using the term 'Socialism with Chinese Characteristics' not once, but seventy-five times in his opening address as president. Nevertheless, in their first

three months in power, Xi and Li both appear to be signaling a serious commitment to embarking on wide-ranging reforms that will rebalance the economy: in his first press conference as premier, Li referred to 'reform' more than twenty times.

The major challenge for Xi and Li is to implement these reforms in a way that not only sustains growth and rebalances the economy, but that also 'unswervingly upholds' the principles of 'Socialism with Chinese Characteristics'. Finding a way to simultaneously reform the system without fundamentally changing it will be no mean feat. Welcome to the tightrope of Chinese politics.

Decision Time

There is a tendency for international commentators to write about what China *should* do to rebalance the economy, as opposed to what it *will* or *might* do. For example, in February 2013, Nicholas Lardy and Nicholas Borst, of the Peterson Institute for International Economics in Washington DC, published 'A Blueprint for Rebalancing the Chinese Economy'.¹ They point out that the imbalances in China's economy have emerged because of distortions to interest rates, exchange rates and energy prices, so rebalancing will best be achieved by *removing* all of these distortions. Their logic is flawless, except for one crucial point: it is highly unlikely that the Chinese government will follow it, because the endpoint of such a blueprint comes too close to a textbook version of unbridled capitalism and, as Hu and Xi have made clear, this is not where the system is headed.

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This does not imply that these distortions will remain fully in place either. In May 2013, the State Council endorsed a set of ambitious reform plans – drafted by the National Development and Reform Commission under the leadership of Xi Jinping – to be presented at the Third Plenum of the Eighteenth Central Committee of the CCP, likely in October this year. The lengthy 'to do' list includes interest rate liberalisation; gradual progress towards capital account convertibility and an increasingly flexible exchange rate; greater fiscal decentralisation; the promotion of private investment in strategic sectors of the economy (including finance, energy, telecommunications and transportation); price reforms in electricity, natural gas, and water; improvements in the social welfare, health and education systems; and the gradual reform of the household registration system to encourage rural-to-urban migration and promote urbanisation.

Headlines in the international media following the release of this list were along the lines of 'China plans to reduce the state's role in the economy', and 'China president takes charge of sweeping economic reform plans': articles that emphasise the government's intention to 'get out of the way'.² But the list is open to a different and, I would argue, more realistic interpretation: as a set of guidelines that will be pursued to the extent that they sustain economic growth (and thus preserve the CCP's main source of legitimacy) and rebalance the economy (even if only gradually, thereby addressing a major source of social unrest), while still maintaining a system that has the façade of being socialist enough to be called socialist.

A few examples illustrate this point:

- First, for decades, the savings of households deposited in low-interest bearing accounts in state-owned banks have been channelled towards large SOEs, local governments, exporting industries, and investment overseas. As a result, local governments have accumulated more than eleven trillion yuan (US\$1.8 trillion) of debt and many of China's state-owned companies may in fact be returning negative real profits, once you account for their access to the cheap credit provided through the state banking system (and a range of other subsidies). Some degree of interest rate liberalisation, to provide household savers with higher returns and increase competitiveness in the banking sector, will assist in rebalancing the economy towards domestic consumers and the credit-starved private sector (which has meanwhile turned to a 'shadow' banking system as an alternative, high-risk source of credit). But rapid, full-blown interest rate liberalisation is highly unlikely because the costs this would impose on SOEs would be simply too great – and, given the principles of a socialist economy, this will not be acceptable;
- Second the People's Bank of China has allowed the exchange rate to become increasingly flexible in recent years, resulting in a substantial appreciation of the Renminbi since 2005. This appreciation has contributed to the decline in China's current account surplus (from a peak of 10.8 per cent of GDP in 2007 to 2.6 per cent in 2012), so it has clearly been beneficial for China in terms of rebalancing away from exports and toward domestic consumption. Equally important, however, is that the stronger currency has increased the buying power of large SOEs seeking

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to invest in energy, resource and other markets overseas, thereby preserving their dominant position in the domestic economy, but also enabling them to strengthen their presence in the global economy as well. In this context, further reforms to the exchange rate regime seem likely;

- Third, urbanisation is seen by many – and Li Keqiang in particular – as the major source of growth for China in the decade ahead, as evidenced by the announcement in June 2013 of plans to move 250 million rural residents into new and expanding towns and cities by 2025. A further relaxation of controls on rural migration is essential for this grand urbanisation plan, which, if effective, will reduce the ‘polarisation’ of China’s urban rich and rural poor and create a huge new pool of domestic consumers. This combination of reforms therefore ticks plenty of boxes in terms of growth and rebalancing without posing any obvious threats to the system itself; and,
- Fiscal decentralisation, to restore the capacity of local governments to raise revenue and reduce their reliance on the state-owned banking sector, is another reform that makes perfect sense in this context. This would facilitate multiple rebalancing objectives, by enabling local governments to finance essential infrastructure for urbanisation, and by freeing up banking funds for the credit-starved private sector. Importantly, fiscal decentralisation would not necessarily reduce the role of the state, but rather shift economic power from higher to lower levels of government. Likewise, ‘encouraging the private sector’ will not mean eliminating the state sector, but rather motivating it to become more innovative, entrepreneurial, competitive and strong. Don’t expect SOEs to vanish altogether. They simply won’t.

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In an April 2013 article in *Foreign Affairs* entitled ‘The Rise of China’s Reformers: why economic change could come sooner than you think’,³ Evan Feigenbaum and Damien Ma are optimistic about the prospects for economic reform in China, on the grounds that three conditions for ‘real and enduring economic change’ are already in place: a crisis of domestic political legitimacy, heightened vulnerability to external economic shocks, and a tough-minded leadership that knows what the problems are, and how to fix many of them, on paper at least. This optimism is well founded, but it can also give the impression to outside observers that fundamental and dramatic change to China’s economic system may be just around the corner. The overriding objective of this policy brief has been to suggest that this impression is misguided. Now we have to wait and see.

Notes

¹ Nicholas Lardy and Nicholas Borst, 'A Blueprint for Rebalancing the Chinese Economy', Peterson Institute for *International Economics Policy Brief* No. PB13-02, February 2013, Washington DC available online at: <http://www.piie.com/publications/pb/pb13-2.pdf>

² See David Barboza and Chris Buckley, 'China Plans to Reduce the State's Role in the Economy', *The New York Times*, 24 May 2013, online at: <http://www.nytimes.com/2013/05/25/business/global/beijing-signals-a-shift-on-economic-policy.html?pagewanted=all&r=0>; and, Kevin Yao, 'China President Takes Charge of Sweeping Economic Reform Plans', *Reuters*, 16 May 2013, online at: <http://www.reuters.com/article/2013/05/16/us-china-economy-reforms-idUSBRE94F17820130516>

³ See Evan Feigenbaum and Damien Ma, 'The Rise of China's Reformers: Why economic change could come sooner than you think', *Foreign Affairs*, 17 April 2013, online at: <http://www.foreignaffairs.com/articles/139295/evan-a-feigenbaum-and-damien-ma/the-rise-of-chinas-reformers>

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The Australian Centre on China in the World (CIW), College of Asia & the Pacific (CAP), The Australian National University (ANU) is an initiative of the Commonwealth Government of Australia in collaboration with ANU, a university with the most significant concentration of dedicated Chinese Studies expertise and the publisher of the leading Chinese Studies journals in Australia. CIW is a national research centre that is jointly managed by a body of academics that includes scholars of China at universities in Adelaide, Brisbane, Hobart, Melbourne and Sydney.

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EDITOR: Geremie R. Barmé · PROJECT COORDINATOR: Ryan Manuel · LAYOUT: Markuz Wernli

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China Story Yearbook 2012: Red Rising, Red Eclipse, August 2012

Stephen Fitzgerald, *Australia and China at Forty—Stretch of the Imagination*, 澳大利亚与中国已届四十年—舒展的想象力, February 2013

Australia and China: A Joint Report on the Bilateral Relationship 中国和澳大亚：关于双边关系的联合报告, with the China Institutes of Contemporary International Relations (CICIR), February 2012

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