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Rebalancing China's Political Economy

Christopher A. McNally
Director, China-US Relations Program
University of Hawaii-Hilo
Nonresident Fellow, East-West Center

Rebalancing China's Domestic Political Economy

- Key to solving the challenge of creating a sustainable basis for future growth in China
- Key to defusing social and regional contradictions/imbbalances in China
- Key to addressing global economic imbalances, including the Yuan-USD currency issue

Rebalancing

- China's political economy is at a crucial threshold
- Imbalances have been building up due to an investment-, export-, and state-centric development strategy
- 12th Five-Year Plan (2011-2015) and a slew of recent policy measures constitute a new policy framework to address these imbalances

Rebalancing

- The following constitutes a comprehensive analysis of recently announced policy measures
- It does not analyze implementation, since this is still a work in progress
- The greatest challenge will be in implementing the new policies, especially given probable resistance by local governments, service providers, large state firms, and others

China's Imbalances

- "Rich government-poor people"
- Saving-consumption
- Rising income inequalities [Wage-profit imbalance; imbalances in China's industrial structure]
- Rural-urban imbalance
- Rich coast-poor interior imbalance
- Man-nature imbalance

Policy

- Many Western/liberal policy prescriptions for solving China's imbalances include the reform of financial markets, stronger market forces overall, strengthening of the service sector, deregulation, strengthening of the private sector, reform of the residency (*hukou*) system, and others

Policy

- Some of these essentially liberal policy measures are being implemented
- But the main policy thrust is one of centralization, standardization, and regulation under state guidance
- Use government in a more effective and concentrated manner
- Aim is to revamp, restructure, and, ultimately, strengthen the state

Policy

- This is a continued state capitalist enterprise, though the state will have to “clip its wings” to engender success
- Interests within the state (especially in large state firms and social service providers) most likely to oppose certain reform measures
- The CCP stands at the center of this reform effort, since its incentive and control systems can make or break efforts to rebalance China’s political economy

The New Growth Pattern

- "A new growth pattern that is jointly driven by consumption, investment and exports"
- Recent policy measures indicate a distinct seriousness about rebalancing and moving China towards a domestic consumption-based growth pattern
- But the party-state is highly unlikely to jettison proven state-centric ways of managing the political economy

State Sector Dividend Pay-out Policy

- State sector to remain dominant in many key sectors, but to remit more in profits to the state (its majority owner) in the form of dividends
- Potential to invest these proceeds into social welfare services
- Redresses "rich government-poor people," saving-consumption, and income inequality imbalances

Social Welfare Reforms

- Addresses various social welfare provisions, including for health, pensions, unemployment, disability, etc.
- Integrated, standardized, and state-centric reform proposals
- Mainly an effort to recentralize and improve control over the provision of key basic social services

Urban Housing Policy Reforms

- "The market system alone is not sufficient" (Han Zheng, Sept 2010)
- Utilize market and tax tools to a considerable extent, especially with regard to new property tax schemes
- But at the center stands the world's largest public housing construction effort – "a return to socialism," though a very limited/stingy socialism

Industrial Upgrading

- Wide use of industrial policy tools to shift industrial growth to new leading sectors: alternative-energy and environmental protection technologies, bio-technology, information technology, high-end equipment manufacturing, advanced materials, etc.
- These new strategic industries' value-added output should account for eight percent of China's GDP by 2015

The Environment

- Serious efforts to address the most glaring environmental concerns
- A proposed system of risk assessment that evaluates new factories and infrastructure projects according to their impact on climate change
- Despite stronger leadership statements, still big gaps in implementation

The Environment

- In a recent essay, China's environment minister, Zhou Shengxian, pointedly notes that "In China's thousands of years of civilization, the conflict between humankind and nature has never been as serious as it is today. The depletion, deterioration and exhaustion of resources and the worsening ecological environment have become bottlenecks and grave impediments to the nation's economic and social development."

China's State Capitalism

- China's emergent political economy represents a reconstituted and refurbished form of state capitalism, including indicative planning and state sector dominance (though with a vibrant, entrepreneurial, and globally networked private sector)
- Now, the Chinese party-state is undertaking a new endeavor: "Socially inclusive capitalism with Chinese characteristics!"

China's State Capitalism

- State refurbishment to guide a more socially inclusive political economy
- Certainly, a CCP initiated and led project – a statist strategy to restore better government control over social service provision and co-opt social interests into supporting the party-state

The Future of China's Capitalism

- The crucial nature of rebalancing China's political economy is likely to prod the CCP to muster the political will to, indeed, improve "people's livelihood"
- The policy initiatives are logical, coherent, and directly aimed at shifting the economy toward increasing household incomes and consumer spending
- Doubts therefore mainly remain concerning the political equation, whether political opposition can be overcome to effectively implement these policies

The Future of China's Capitalism

- Mutual strengthening of state, society, and economy in reinforcing virtuous cycles during China's reforms?
- Not "the market wins, the state loses" or vice versa
- Key is for the CCP controlled cadre incentive system to move away from emphasizing GDP maximization to a focus on quality of life measurements

The Future of China's Capitalism

- The state sector dividend policy most clearly expresses the state-centric nature of China's efforts
- There is no intent whatsoever for large state firms to give up the commanding heights of the economy
- Rather, the state is aiming to recentralize control over state sector earnings, using them as a valuable resource to support greater social service spending

The Future of China's Capitalism

- The Chinese state thus is “clipping its own wings” to expand more effectively into a variety of areas of social spending
- While part of the policy package includes limited liberalization and marketization, China's historical background continues to foster state-centric policy solutions
- This poses a challenge to our understanding of what constitutes the key to successful and sustainable economic development

The Future of China's Capitalism

- Could state capitalist and state-centric solutions be more amenable to the challenges facing globalizing and developing political economies?
- George Soros notes that if China's model of state capitalism becomes "the envy of the world," many other developing economies could follow
- "Perfect order and global governance are not realistic expectations. However, it is a sad fact that Western democracies provide less successful leadership than China"

Global Implications

China's capitalism thus espouses values, international viewpoints, and domestic institutional arrangements and power relations fundamentally different from those characterizing Anglo-American capitalism

Global Implications

- Less trust of markets; more trust in the state and social norms of stability and hierarchy
- More socialist rhetoric that does have some influence on public discourse
- Less emphasis on legal norms and standards; more emphasis on interpersonal relations built on reciprocity, human empathy, and trust → *Guanxi* capitalism

Global Implications

All of this implies that the world will be faced with a **massive** political economy that is a “developing nation” with a very different type of capitalism → **Sino-capitalism**

Global Implications

Sino-capitalism and its increasing global importance reflects the broader clash of various forms of state-led capitalist systems (e.g., Brazil, Russia, India, Saudi Arabia) with the liberal international order

This conflict runs much deeper than the fissures exposed by the global financial crisis and expresses fundamental differences over how political economies should be governed

Global Implications

International governance is likely to become a lot more complex and contested

Difficulties to reach effective global consensus on economic matters (and beyond) are clearly rising → G-20 expresses the fundamental differences in viewpoints

Global Implications

ILLUSTRATION: Fundamental debates about the rules of economic governance pitting three "schools" against each other:

1. Austrian "pure market" school (let economic cycles play out on their own → "creative destruction")
2. Bastardized Keynesian school (let markets play out on the way up; let government intervene on the way down)
3. Pro-active Keynesian counter-cyclical school (manage cycles, especially on the way up as bubbles form by reigning in money supply, managing demand, and tightening regulation)

Global Implications

- Nonetheless, a successful rebalancing of China's political economy could have very positive effects on the global political economy:
 - Increase demand in China
 - Diminish global imbalances in terms of saving and consumption
 - Make China a driver of global growth not only in resource industries, but also in consumer goods

Global Implications

- Rebalancing China's political economy also could make China less dependent on US export markets and technology
- It could therefore accelerate the unfolding power transition globally between China and the US

Thank You!

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