



The China Symposia

(A series to develop a broader and deeper multi-dimensional understanding of China)

Session on

China's Domestic Economic Policy – A Critical Understanding

With a focus on China's 'new normal' and 'the fourth generation reforms'

17 November 2015

Time: 5:45 pm – 7:15 pm

Venue: India International Centre, New Delhi

The Institute of Chinese Studies in collaboration with the Ananta Aspen Centre and the India International Centre conducted its second session of 'The China Symposia', a series of six events to be held in the coming months. The China Symposia aims to develop a broader and deeper multi-dimensional understanding of China. The theme of the second symposium was 'China's Domestic Economic Policy – A Critical Understanding', with its focus on China's "*new normal*" and "*the fourth generation reforms*".

The distinguished speakers included Dr. Huaizhu Xie (Division chief and Research Fellow, Division of International Finance, Research Bureau, People's Bank of China), Dr. He Fan (Chief Economist and Managing Director, Caixin Insight Group, China) and Dr. Sanjaya Baru (Director, Geo-economics and Strategy, International Institute of Strategic Studies (IISS), London and Hon. Senior Fellow, Centre for Policy Research, New Delhi). The session was chaired by Ambassador Jaimini Bhagwati (RBI Chair Professor, ICRIER and Former Indian High Commissioner to the United Kingdom).¹

Ambassador Jaimini Bhagwati in his opening remarks mentioned that a critical understanding of

¹ See the 'programme details' for detailed bios of the speakers and the chair.

Chinese domestic economic policy necessitates a methodical and thoroughgoing approach. He mentioned that developing nations are at a critical juncture given the developments in the last seven years wherein the central banks of developed countries such as U.S., Japan, and the G7 countries have pumped in about 7 to 8 trillion dollars of liquidity into international financial markets, out of which a substantial portion has gone into China and many other developing and emerging economies. However, these developments have also given rise to an asset bubble, devaluation of the Chinese currency and the growing menace of shadow banking in China. Meanwhile, the economies of the G7 nations have been recovering quite rapidly even while China's new economic policy that focuses away from manufacturing has affected commodity producers.

Dr. Huaizhu Xie stated that China – as also its financial system – is currently going through a major economic transition. The fall of China's economic growth from 10 percent to 7 percent has now become the 'new normal'. Central banks react to shocks that are both internal and external. One kind of shock is a short-term shock, like the Paris terrorist attack. Central banks are generally not concerned about short-term shocks unless they have a monetary impact resulting in a medium term shock. However, the central bank usually reacts to cyclical and structural shocks. Hence, the big question is whether the slowing down of China is cyclical or structural in nature? If it is cyclical, usually there is a policy to meet the shock. For instance, if the growth rate of China falls from 10 per cent to less than 7 per cent, the bank has to respond to it as a cyclical change. However, if the growth rate stays at about 6 per cent, then it is not a negative shock. It would be seen as positive, but it needs a structural change. Hence, it is both a cyclical and structural shock. Given China's high and rapid economic growth for so long, it was normal (in the sense of natural) for it to undergo structural changes. She explained China's current economic transition by drawing comparison with developed economies such as United States, Netherlands, and Japan who underwent similar experiences in the process of their economic transition. She also mentioned that it is not practical for China to continue to maintain a high economic growth of 10 percent beyond 30 years. With the changing social order and rise in the living standards, availability of cheap labour and other resources has declined and it is necessary to make adjustments in view of the new social order. Hence, Chinese economy has to make structural changes such as maintaining high growth through capital inputs for technological innovation accompanied by a decrease in manual labour in order to achieve growth equilibrium. Demographic changes such as an ageing population have a huge impact on the economy with decline in cheap labour from the rural areas. The other characteristic that the speaker pointed out was the high rate of consumption and low investment rate currently being experienced by China. The speaker also threw light on the issue of devaluation of Chinese currency, which according to her is based on three

factors: overseas market, Hong Kong market and the actual market. Offshore, China's RMB is not convertible. She also mentioned that market is not the most important sector as there are other factors such as employment and social services.

Dr. He Fan in his presentation pointed out that the Chinese economy is facing a downside effect. He referred to the low level of international investment in infrastructure development in China to substantiate his point. China has to build up both its skilled and unskilled labour sectors. High economic growth is important but ensuring productive employment and achieving financial stability are equally important goals for the Chinese economy. However, trying to achieve all three is not possible and he called it the 'impossible triangle'. China is currently experiencing this very dilemma. He further mentioned that the government can reinvigorate domestic economy by identifying the sectors that can be competitive and provide employment. In his assessment, the healthcare sector in China could be a good example in this regard. Ageing population and lack of proper health care facilities makes this sector highly appropriate for investment – it would not only provide good health care services but also ample employment opportunities for both young and middle-aged people. He emphasized the crucial role of the Chinese government to build the necessary capacity for this sector.

Dr. Sanjaya Baru began his presentation by highlighting that his primary interest lies in China's external economic policy. Both India and China are at very different levels of income and development but continue to face the same dilemma, which is that the external world is not offering them enough opportunities for growth. So the important question is how to sustain growth in an increasingly difficult global environment. Technically, economic theory would suggest a rebalancing of the economy from investment-led to consumption-led growth. Often one assumes that theories predict growth, however, if that growth is not happening, then it means that there is something wrong – either with the theory or the policy. He pointed out that it was not clear as to whether there is a problem with the theory or whether it should be understood as a political problem. Rebalancing from investment to consumption is not merely a technical exercise but a social exercise as well. It involves redistribution of income and affects different social classes. China's domestic policy recalibration will therefore have both social and political consequences. He agreed with Dr. He Fan that the health sector is an acceptable sector for this recalibration. He also mentioned the challenges of maintaining a high growth record in the face of an increasingly hostile international environment and hence, the challenge is to accept and manage lower rates of growth, at least in the medium term. Given the Chinese leadership's objective of internationalisation of the Renminbi, there would be some policy consequences from the current slowdown. According to **Dr. Baru**, there are two dimensions to this.

One is the post-2008 general economic slowdown and the inability of both U.S and European Union to revive growth as a result of which global growth has suffered due to fiscal and monetary strains operating on these G7 economies. The second is the global trading system. The rise of a regional trading system will hurt growth further even as it gives a greater voice to the developing countries like China and India. The speaker also focused on how India and China can sustain growth by an increase in the domestic demand. This is being done by rebalancing from investment to consumption in China. He assessed the present situation as an economic dilemma and pointed out that the 'new normal' is not a natural state of progression but imposed by the problems in rebalancing from investment to consumption as also by external global factors. **Dr. Baru** reiterated the need to boost global trade – that is, regionalisation of trade, viz, the TPP and TTIP, which are headed by the U.S have left out the BRICS. Hence it is not a good idea to regionalize trade. He emphasised that the approach in responding to this 'new normal' should be through strengthening the multilateral institutions and not moving towards regionalism in trade and finance. He believes that China has a sophisticated understanding of both the slowdown and the ways to deal with the same.

Discussion

The ensuing discussion involved a host of questions pertaining to China's one child policy, ageing demography and environmental policies, how these contributed to the 'new normal' and what the response of the Chinese government would be. It was mentioned that the Chinese government has opened many new regions and is now focussing on the domestic market. This has in a way contributed to the rise of regionalism in trade, which is a threat to the established multilateral trading system.

Another set of questions raised during the discussion ranged from the implications of internationalisation of currency in China; the export factor in OBOR; shift from extensive to intensive growth; the bad debts problem being faced by China in its banking sector, especially by local governments; environmental concerns and the restraints it places on the Chinese economy. **Dr. Huaizhu Xie** responded to questions about the effect on the global financial market, or the mutual spill over, as emerging economies make huge investments in the U.S treasury. This will determine the long term yield for the U.S, and this is mutually determined by the international investment from China, Japan and other emerging economies. **Dr. He Fan** mentioned that the Chinese central government is more comfortable with a lower growth rate and they have already experienced the very high but unbalanced growth rate. This was one of the lessons learnt in the last two decades. 'OBOR'

is a good strategy but the question is about managing it. The most serious challenge for China is not about avoiding an American type financial crisis but probably what happened in Japan in the 1990s with ailing companies and banks and ending up with a group of ‘zombie companies and banks’. That will be the most serious challenge for China. With regard to environmental issues, domestic political matters are very important. **Dr. Sanjaya Baru** mentioned that ‘OBOR’ is more an attempt at sustaining investment rather than promoting exports. It is a long term strategy and aims at externalising investments across the Eurasian land mass.

About the 2nd China Symposium

The 21st century is marked by the unprecedented growth of China, The current paradigm within which economic discourse in China is taking place is – the ‘New normal’. Broadly understood in terms of espousing a sustainable economic growth trajectory, the Chinese President Xi Jinping in his speech at the APEC summit in November 2014, underlined the significance of ‘new normal’ as a way to transform the ‘rapid growth into high-growth’. The recent currency devaluation and the falling profits of the Chinese manufacturing sector is raising doubts over China’s ability to pursue the ‘new normal’ approach. The continuing party-state led control over economic affairs raises questions about the expected deliverables in this regard.

With the 13th Five Year Plan round the corner, the focus of world interest would be on whether the oft-announced fourth-generation economic reforms would begin in earnest and whether the Chinese government would scale up its policies to de-regulate micro-economic controls. Would it take up the financial reforms necessary to provide the private sector with a level playing field in terms of access to capital and technology? In the session, both Chinese and Indian experts will address various issues related to China’s domestic economic policy.

Disclaimer

This report is a summary produced for purposes of dissemination and for generating wider discussion. All views expressed here should be understood to be those of the speaker(s) and individual participants, and not necessarily of the Institute of Chinese Studies.