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THE CHINESE ECONOMY: CRISIS, CONTROL, RECOVERY, REFOCUS

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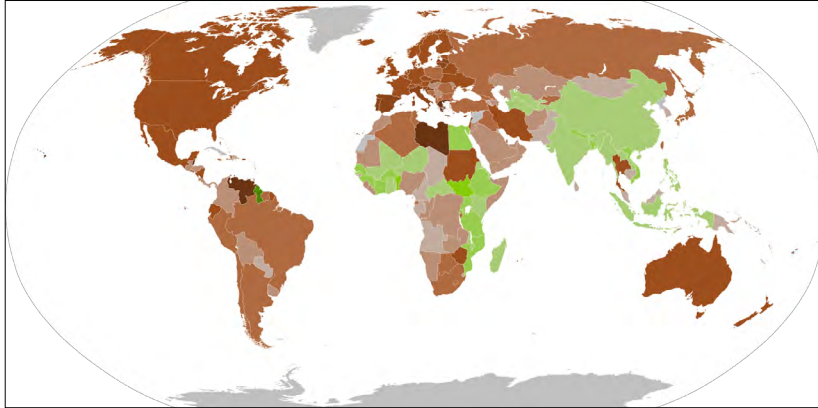
HEADING INTO 2020, the economy of the People's Republic of China (PRC) was weighed down by familiar challenges: adverse demographics, a heavy debt burden, falling productivity growth and more. Still, China was again set to outperform in the global economy. On 20 January, the International Monetary Fund (IMF) projected China's economic growth in 2020 would sit at 6 percent — a fraction less than the year before but more than triple the pace expected in advanced economies. It was also just within the New Normal rate of gross domestic product (GDP) growth of between 6 and 7 percent that has been the official target set by President Xi Jinping 习近平 and Premier Li Keqiang 李克强 since 2014.¹ China's outlook was also buoyed by the signing on 15 January of a 'phase one agreement' on trade with the United States, which was viewed optimistically as a circuitbreaker for the tit-for-tat escalation in tariffs since early 2018.

Yet by mid January, the outbreak of the novel coronavirus (COVID-19) was well under way in Wuhan. It was 23 January when the metropolis of 11 million residents was locked down, with *The New York Times* observing that day that the virus had ‘cast a pall over growth prospects for the world’s second largest economy’.² A ‘new abnormal’ era — albeit with some familiar echoes from the past — had begun.

Domestic Developments: Crash, Rebound

Early assessments of the damage inflicted on China’s economy by the pandemic were complicated by the fact that production had already begun shutting down for the annual Spring Festival break, originally scheduled for 24–30 January, but extended to 2 February ‘to strengthen the prevention and control of the novel coronavirus outbreak’.³ By the time work at offices and factories was officially allowed to restart, many restrictions on travel remained in place throughout the country — reportedly affecting around 500 million people.⁴ Real-time indicators of economic activity such as road congestion and electricity consumption, remained at a fraction of normal levels.⁵ On 29 February, the National Bureau of Statistics (NBS) published its manufacturing Purchasing Managers’ Index (PMI) — a measure of factory activity. With 50.0 being the dividing line between month-on-month expansion and contraction, and also the value that was recorded in January, February’s reading of 35.7 showed the fastest rate of collapse on record. The official index covering the services sector was even worse, falling from 54.1 to 29.6.⁶

As the central authorities became increasingly impatient to get the economy moving again, local media reported that lower-level officials were meeting ‘back-to-work targets’ by instructing firms to power up idle equipment and turn on factory lights at night in an attempt to game performance measures by boosting electricity consumption.⁷ In the middle of March, the NBS announced that the official unemployment



Map of the projected real GDP growth rate in 2020 of countries in the International Monetary Fund's *World Economic Outlook* (April 2020). Green colour indicates improvements and red indicates deteriorations; the darker the colour, the greater the degree
 Source: Wikimedia

rate had jumped to 6.2 percent — the highest on record.⁸ But even this did not capture the millions of migrant workers who had not returned to the cities following the Spring Festival break, so the real unemployment rate was undoubtedly much higher.

On 20 April, the NBS issued grim confirmation that the economy had shrunk by 9.8 percent in the first quarter compared with the last quarter of 2019, or 6.8 percent in year-on-year terms.⁹ In the first quarter of 2009, in the wake of the Global Financial Crisis, the PRC's year-on-year growth rate slumped, but to a still-positive 6.4 percent, down from 9.5 percent six months earlier. The effects of COVID-19 seemed to have taken the meaning of economic crisis to a new level.

From April, however, the economy picked up. By the time the IMF released its *World Economic Outlook* report in October, its forecast for China's 2020 GDP growth had increased to 1.9 percent (compared with a June forecast of 0.8 percent). By contrast, the forecast for India had been downgraded to a contraction of -10.3 percent (more than double the already devastating -4.5 percent predicted in June); and the projection

for the US was -4.4 percent. Indeed, by October, China was the world's only major economy projected to record positive growth in the year.¹⁰ This feat was confirmed — according to official data at least — with the NBS reporting in January 2021 that China's economy had expanded by 2.3 percent in 2020.

How did China manage to perform so well while the global economy was crumbling? Emergency government interventions played a big role initially. The most prominent of these was the RMB 3.6 trillion (US\$500 billion) fiscal stimulus announced in May — the equivalent of 4.5 percent of Chinese GDP — taking the country's budget deficit to 3.6 percent of GDP, above the longstanding ceiling of 3 percent.¹¹ The stimulus followed the familiar playbook of primarily targeting investment in infrastructure (as discussed in Chapter 5, 'China's Post-COVID-19 Stimulus: Dark Clouds, Green Lining', pp.139–153) and property development, while Chinese households by and large received no direct support. This was evident in China's second quarter GDP growth rate of 3.2 percent (year-on-year), to which investment added 5 percent while consumption subtracted 2.3 percent.¹²



Premier Li's declared that street vendors represented the 'livelihood of China'
Source: Azchael, Flickr

Supporting a more organic economic recovery from April was the fact that China managed to get the public health crisis under control, allowing restaurants and retail outlets to join factories in reopening their doors. But a stalled agenda for economic reform undermined the sustainability of China's continued growth. The Asia Society's *China Dashboard*, which tracks the progress of economic reforms across ten domains, revealed that, during the first six months of 2020, only two of these domains (land and state-owned enterprises) showed minor improvements, with downgraded assessments for competition, the financial system, innovation and labour, and stagnation for the remaining four: cross-border investment, the environment, fiscal affairs, and trade.¹³

Labour was hit the hardest, with evidence that all labour indicators — including unemployment rates, migrant wages, and job creation — 'deteriorated and are now in uncharted territory as policies failed to support workers during the pandemic'. One of the only vaguely positive signs in the mix was Premier Li's declaration in June that street vendors represented the 'livelihood of China', and he encouraged them to 'come alive, survive, and develop'. Shortly thereafter, at least twenty-seven cities, including Shanghai (but not Beijing), began to bring back street vending, contrasting starkly with past crackdowns on street stalls in the name of 'urban beautification'.¹⁴

All this was despite the fact that, in April and May, Beijing announced two sets of guidelines, on 'making market mechanisms more important' and 'speeding up the improvement of the socialist market economic system in a new era'.¹⁵ These guidelines implicitly recognised that the ambitious reform agenda to which the Third Plenum of the Central Committee back in 2013 had committed (see the *China Story Yearbook 2014: Shared Destiny*, Chapter 1, 'Great Expectations', pp.21–37) had not been fully implemented by 2020.

The Party Leads All

The Nineteenth National Congress of the Chinese Communist Party (CCP) in October 2017 endorsed the writing into the Chinese Constitution of President Xi's Four Confidences — in the path, theory, system, and culture of Socialism with Chinese Characteristics (see Chapter 1, 'The Construction of Political Superiority', pp.13–21). He reiterated this formula in various speeches throughout 2020, as well as emphasising the centrality of the power of the Party, which was encapsulated in his now well-worn phrase: 'Party, government, army, society, and education — east and west, south, north and centre, the party leads all.'

This expression was first used by Mao Zedong in 1962, during a conference that 'saw a broad pushback against Mao and his radical leftist policies' following the Great Chinese Famine (1959–1961) that left tens of millions of people dead.¹⁶ Xi, like Mao, reportedly facing internal criticism, strengthened both his control over the Party and the Party's control over most aspects of Chinese politics, economics, and society throughout 2020. In September, the Party ordered the United Front Work Department to work more closely with business to strengthen the government's leadership role in the private sector, by 'strengthening ideological guidance' and 'creating a core group of private sector leaders who can be relied on in critical times'.¹⁷ Neil Thomas from the Paulson Institute reminds us that, in Xi's China, while ideology is framed as supporting 'comprehensively deepening reform', this reform is not always market-oriented. Rather, it can also be directed at enhanced 'governance' with the ultimate goal being for the PRC 'to escape the middle-income trap and achieve comprehensive national power'.¹⁸

While some entrepreneurs may have found Xi's commitment to doing 'better in promoting the healthy development of the private economy' reassuring, especially after previous, less encouraging signals, it is unlikely they were comforted by his intention to 'unify members of the private sector around the Party'.¹⁹ (See the *China Story Yearbook: China*

Dreams, Forum, ‘Xi Jinping’s War on “Black and Evil”’, pp.37–41.) A case in point is China’s richest man, Jack Ma 马云, who was worth US\$61.1 billion in mid-November 2020 according to *Forbes*’s ‘real-time billionaire’ list.²⁰ Ma, a longstanding member of the Communist Party, co-founder and former executive chairman of Alibaba and owner of its affiliate Ant Group, the world’s highest-valued fintech company, was also



China’s richest man, Jack Ma
Photo: Paul Kagame, Flickr

ranked by *Forbes* as the twenty-first most powerful person in the world in 2018 (only two PRC citizens outranked him: President Xi at number one and Premier Li at number fifteen).²¹ In late October, Ant Group was poised for what was expected to be the world’s largest-ever initial public offering (IPO): a hotly anticipated dual listing in Hong Kong and Shanghai valued at US\$30 billion. But then reports broke that Xi had personally halted the IPO. The immediate cause appeared to be a speech given by Ma in October in which he criticised global financial regulations. There was also speculation that Ma had pushed the limits of his personal power too far in recent times; Xi was ready to rein him in.

In times of crisis, the mechanisms the Chinese government has at hand for stimulating economic growth may be superior to those of liberal democracies, where there is no omnipotent central power that can make decisions without consultation. It is certainly easy to imagine that the events of 2020 confirmed for the CCP one of their basic tenets of faith, the ‘superiority of the socialist system’. Yet by clutching too tightly to the notion of a state-controlled economic system while clamping down on wealthy entrepreneurs and failing to provide for

the country's least privileged workers (numbering in the hundreds of millions), they may be sacrificing the sustained economic growth and social stability that Xi and his party crave in the longer term.

The Global Economy: Conflict and Co-operation

The Sino-American 'phase one agreement' on trade may have paused the escalation of tariffs, but the relationship between the world's two superpowers deteriorated in 2020 (as discussed in Chapter 7 of this volume). In April, Orville Schell wrote in a *Foreign Policy* article titled 'The ugly end of Chimerica': 'The best hope is that the US and China remain in the foothills of a Cold War, and don't ascend to its heights.'²² While not everyone accepts that a new Cold War has begun, in 2020, both the US and China increasingly pursued their conflicting geopolitical objectives by using economic tools to punish or reward: the US focusing its efforts on China; China focusing its own 'geoeconomic' proclivities elsewhere.

Chinese companies and individuals continued to suffer under trade restrictions, with President Trump seeming to pick his targets at random, from WeChat and TikTok to the possible delisting of Alibaba. He introduced new restrictions on Chinese researchers and students in the US and imposed sanctions on fourteen PRC officials for their connection to the suppression of democracy in Hong Kong. Perhaps no company felt the heat more keenly than Huawei, when in August, the US government announced that any foreign companies using US technology to supply Huawei with the semiconductor chips required for its smartphones and 5G equipment would have to apply for a special licence. *Fortune* magazine observed that, should these licences be denied, it would amount to a 'death sentence' for the tech giant.²³

Overwhelmingly, however, Trump's tariffs on Chinese goods were being paid by American consumers, adding between several hundred and one thousand dollars to average annual household expenses.²⁴



TikTok would face a complete ban if it did not sell to a US company by 14 November
Source: Solen Feyissa, Flickr

Retaliation by Beijing also saw the average tariff rate on US imports climb to 25.9 percent by the beginning of 2020, up from 8.0 percent two years earlier; at the same time, China was cutting tariffs on imports from other countries.²⁵

The ‘phase one agreement’ struggled to deliver the volume of additional US exports Trump promised it would. In October, Chad Bown from the Peterson Institute for International Economics found that, through the first three quarters of 2020, China had reached only 53 percent of its target purchases of US exports for the full year; Chinese imports of US goods were ‘lower than they were before Trump started his trade war’ in 2018.²⁶ That same month, *Reuters* reported that some 3,500 US companies, including Tesla, Ford, Target, and Home Depot, were suing the Trump administration over the US\$300 billion tariffs imposed on Chinese imports — a revealing sign of the internal damage Trump inflicted via his ‘punishments’ of China.²⁷

Geopolitical tensions and the economic damage caused by the pandemic had a more mixed impact on capital flows. In the first half of 2020, direct and venture capital investment between the US and China fell to its lowest point since 2011.²⁸ Yet by October, the *Financial Times* was reporting that Beijing and Wall Street were ‘deepening ties despite geopolitical rivalry’, with US portfolio investment capital

pouring into Chinese government bonds, which paid much higher yields than American ones: 3.18 percent compared with 0.8 percent. As Cornell University's Eswar Prasad explained: 'Economic imperatives are certainly overriding political concerns. Ultimately, private capital and private financial institutions are going to respond more to economic incentives irrespective of what political masters say.'²⁹

Australia, meanwhile, was bracing itself from February for the knock-on economic effects of the pandemic on its most significant trading partner. On 27 February, *Bloomberg* published a feature with the headline 'The world's most China-reliant economy reels from virus shock waves', adding that developments had 'fuelled questions over whether the nation is too reliant on the Asian behemoth'.³⁰ Some security and strategic analysts were quick to answer in the affirmative.³¹ Economists, on the other hand, pointed to data suggesting that Australia's trade exposure to China might turn out to be a strength rather than a weakness³² — or even a 'blessing in disguise'.³³

The political relationship between Australia and China took a battering in 2020, with Australia targeted by Beijing for a series of 'geoeconomic punishments'³⁴ (see Chapter 9, 'Economic Power and Vulnerability in Sino-Australian Relations', pp.259–274). Yet Australian trade with China showed resilience in aggregate. China accounted for 38.2 percent of Australia's goods exports in 2019.³⁵ By the end of 2020, this share had risen to 40.0 percent, while the total value was



Australian beef sold in a Chinese supermarket
Source: myzaker.com

down by only 2.1 percent on the same period a year earlier, which had represented a record high. Goods exports to all other countries were down by 9.9 percent.³⁶

This paints a slightly different picture than that commonly presented by media reports. These understandably focused on the ever-growing list of Australian export sectors and companies that were coming under pressure from China, with Beijing's 'plausible denial' that the restrictions were not imposed for political reasons becoming increasingly implausible. By year's end, Australian wine, lobster, sugar, coal, timber, wool, barley, and copper ore were in the firing line, and the export value at risk was projected at AU\$20 billion. While the macroeconomic consequences of a shock of this scale were limited — hence feeding into a picture of resilience in aggregate — there is no doubt these individual sectors suffered significantly and some individual firms suffered enormously.

Beijing's actions towards Australia sat uncomfortably alongside Xi's claims that China would be a responsible, inclusive and co-operative global power in the face of the 'indisputable reality' of economic globalisation or, as he put it in his statement to the UN General Assembly in September 2020:

We should see each other as members of the same big family, pursue win-win co-operation, rise above ideological disputes, and not fall into the trap of 'clash of civilizations' We should pursue open and inclusive development, remain committed to building an open world economy, and uphold the multilateral trading regime with the World Trade Organization as the cornerstone.³⁷

Nonetheless, in some areas, Xi lived up to his word. In November, fifteen countries in the Asia-Pacific — including China, Japan, Association of South-East Asian Nations (ASEAN) members and Australia — signed the Regional Comprehensive Economic Partnership (RCEP), a major trade agreement covering some 30 percent of global GDP. This was widely interpreted as



Regional Comprehensive Economic Partnership (RCEP)

Photo: Wikimedia

a geopolitical (or geoeconomic) victory for China, signalling its capacity to step into the void left by Trump's decision to withdraw from the Trans-Pacific Partnership back in 2017. A Peterson Institute for International Economics working paper concluded that lower trade costs, especially among China, Japan, and Korea, would 'accelerate the decoupling of the East Asian and US economies',³⁸

China further courted parts of the world that may have felt abandoned by Trump's 'America first' policies both before and during the pandemic. It did this through the provision of foreign aid including donations of critical medical equipment. Critics have noted that there were problems with substandard equipment and the aid tended to flow

to ‘friendly’ countries like Italy and Serbia, while neglecting supporters of Taiwan such as Haiti, Honduras, and Paraguay.³⁹ Yet its relief efforts across the globe were undeniably substantial, including

A \$20 million donation to the World Health Organization (WHO), sending doctors to Iran and Italy, building a Polymerase Chain Reaction (PCR) laboratory in Iraq to increase the country’s coronavirus testing capacity, donating test kits to the Philippines and sending protective equipment to Pakistan and France.⁴⁰

Beijing also agreed to participate in the G20’s Debt Service Suspension Initiative, delaying loan repayments to 77 low-income countries, alongside promising to build hospitals and send medical experts to countries across Africa — although the picture there was complicated. (See Forum, ‘Chinese Loans to Africa: Trap or Treasure?’, pp.243–246.)

Xi’s Solutions: Self-Reliance and Dual Circulation

With the global economy collapsing around them and tensions with the US continuing to run hot, Chinese leaders became increasingly vocal about a pair of solutions with strong echoes of the past: ‘self-reliance’ 自力更生 and ‘dual circulation’ 双循环. Both concepts explicitly recognise new limits to the global interdependence that has propelled China to its current position as a global economic power — and to ‘Chimerica’ in particular.

‘Self-reliance’ is a term familiar from the Maoist era of command economic planning and is set to become so in the Xi era as well. As Xi stated during his tour of southern China in October, ‘we need to take the road of self-reliance on a higher level’.⁴¹ During this tour, and in speeches throughout the year, Xi emphasised the need for a greater reliance on domestic demand and for technological self-sufficiency to underpin ‘high-quality’ development of the domestic economy at a time of ‘major changes’.

These are two of the key prongs of Xi's Dual Circulation Strategy, which came into focus in May, when he declared that China would 'fully develop the advantages of [the country's] super-large market and the potential for domestic demand to establish a new development pattern featuring domestic and international dual circulations [双循环] that complement each other'.⁴² The Fourteenth Five-Year Plan (2021–2025), due for release in early 2021, should provide more detail. Dual circulation does not signal a fundamental shift in China's development strategy. Rather, it builds on the 'rebalancing' strategy first introduced by then president Hu Jintao back in 2007, which (largely unsuccessfully) sought to reduce China's reliance on exported growth and to boost domestic consumption.⁴³

The stakes are arguably far higher than they were previously, with Sino-American strategic rivalry unlikely to diminish under a Joe Biden presidency. Even past vocal advocates for greater economic engagement with the world, such as Yao Yang 姚洋 of Peking University, recognise that increasing 'internal circulation' is a necessary, if costly, response to the US administration's determination to 'punish China's high-tech companies and other entities'.⁴⁴ While acknowledging that 'US moves to isolate China from the global technology supply chains have dealt a blow to the Chinese economy', Yao insists, 'this will not stop China's rise'.

The COVID-19 crisis may finally be easing but the debates it brought into sharper focus — about the role of state control versus market forces and individual freedom, international decoupling versus interdependence, and the best path to sustained economic growth — will continue for decades to come.

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