

# China's Economic Challenges Over the Next Five Years



**Seung Shin Lee**

Ph.D., Research Fellow, Chinese Economy and Trade Team  
Korea Institute for International Economic Policy

At the 20th National Congress of the Communist Party of China held in October this year, President Xi Jinping's third consecutive term was decided, and the top leadership was formed mainly by Xi's aides, making it difficult for diverse views to be reflected in the decision-making process. As President Xi's one-man control system is firmly established, there are also concerns about the future direction of the Chinese economy. This article reviews the transformation and changes of China's economy from the perspective of Xi's governance philosophy and policy adjustment process, concluding with a discussion of possible developments and changes in China's economy.

In 2012, Xi Jinping became the general secretary of the 18th National Congress of the Communist Party of China and de facto leader of China. At the time, the Chinese economy was slipping from a double-digit growth rate, causing a whirlpool of concern over whether the GDP growth rate could be maintained at 8%. Having worked in Fujian and Zhejiang for many years, Xi was seen as understanding the dynamism of the private economy and the market.

At the beginning of his tenure as the top leader, Xi was open to promoting market-oriented reforms. The communiqué of the Third Plenary Session of the Eighteenth Central Committee held in 2013 declared that the market should play a decisive role, and praised market-oriented regulators who supported stock investment and deregulation of the renminbi, and even considered the suggestion that state-owned enterprises be run by professional managers rather than party organizations.

In mid-2015, China's stock market was rocked by a sharp rise and fall in the stock market, while the central bank's deregulation of the renminbi and exchange rate reforms added to public panic, embarrassing and angering President Xi Jinping, who ultimately resorted to state administrative controls to address what he believed to be failures of the market. The original plan to put more market-minded managers in charge of state-owned enterprises was also aborted. Emphasizing top-level design is a characteristic of the Xi era, with stress being placed on comprehensiveness and systematicity, breaking away from the previous strategy of "crossing the river by feeling the stones" in search of breakthroughs. Promoting reform is difficult, and a matter related to the solidification of vested interest groups. Therefore, by controlling corruption, the obstacles of vested interests may be eliminated. Reform emphasizes how systematicity, economic, political, social, cultural and ecological aspects must go hand in hand.

In 2017, when the 19th National Congress of the Communist Party of China was held in China, the power of President Xi Jinping was solidified, and the nation's blueprint for economic development was revised to clearly place economic growth with quality, not speed, as the goal of governance. Following this, ecological environment governance and poverty eradication became the criteria for evaluating recent political performance, and preventing potential risks of reform the governance bottom line requirements.

In 2021, after the Chinese authorities basically completed the task of alleviating poverty, addressing the immediate problems of high expenditures related to housing, education, and health care, they launched a series of policies to advance towards common prosperity. These included, for example, strengthening lending regulations on real estate purchases to curb the soaring real estate market, imposing strict restrictions on the once booming off-campus tutoring training industry, and enacting a plan to reform health care. The measures underscore a willingness to narrow the gap between rich and poor at the expense of economic growth. For President Xi, shaping China into a fairer, more self-reliant economy and giving the government a leading role in mobilizing investment and resources to achieve strategic goals has been a major goal. During the course of their administration, President Xi and senior officials gradually came to realize that the market and private economy, though important to China's rise, cannot be predicted or fully

trusted. The view that the state planning model is more suitable for managing a complex economy has become mainstream, and certain policy trends to strengthen control have gradually emerged, including the Chinese government installing more members of the Communist Party of China at private enterprises, cutting off some private enterprises' credit channels, and asking the top executives of state-owned enterprises to adjust their operations to meet national goals.

The era of President Xi Jinping faces many internal and external challenges. The U.S.-China strategic confrontation is an unprecedented change in China's 40 years of reform and opening up. President Xi Jinping lifted the restrictions on state leaders after the 19th National Congress of the Communist Party of China, and the trend of personal centralization has deepened the outside world's doubts about China's "peaceful rise." Meanwhile, the impact of the COVID-19 epidemic on the global supply chain since 2020, the Russian-Ukrainian war in 2022, and the adjustment of the global geostrategic alliance following these major events not only affects the space for China's international development from the outside, but also compresses the space for further market-oriented reforms internally.

The key to China's development is the bottleneck of its own growth. As consumption cannot be the key to economic growth, investment has become the main force driving economic growth. In the face of the gradual saturation of infrastructure investment, return on infrastructure investment is diminishing, which is a driving force for economic growth. The power is weakened, and excess capacity is gradually formed. To improve capital efficiency from the supply side, it is necessary to start with innovation and industrial upgrading. The expanding growth of state-owned enterprises and the shrinking of private enterprises' development space have resulted in the expansion of capital to areas with low productivity, and many industries have shown a trend of being dominated by the government.

Revitalizing consumption is the key to China's recovery of economic growth momentum. The widening gap between the rich and the poor is detrimental to consumption. After President Xi Jinping lifted poverty by all means, he continued to promote rural revitalization in an attempt to narrow the income gap between rural and urban areas, but having migrant workers settle down in cities may be more a practical way to achieve this goal. Therefore, in the future, the household registration control should be opened in big cities, also solving the problem of rural land transfer, so that farmers can have the capital to go out for development, and even let urban capital have the opportunity to enter rural development sectors. Only by implementing and solving these ageing reform problems can production factors be fundamentally allowed to flow between urban and rural areas in accordance with market principles. This is the solution to the bottom line.

Even before the outbreak of the epidemic, China's economic growth rate had dropped from the previous high of 10% to 6%. Due to the rapid resumption of work and production after the epidemic, China has become an important pillar of the world supply chain. China's regime has regained confidence in its rule, implemented a Zero-COVID policy in epidemic prevention, adopted a more cautious macro-expansion policy, and actively promoted near-control measures toward common prosperity. In the second half of 2021, the economy showed a downward trend again, with GDP growth of only 4% in the fourth quarter and 4.8% growth in the first quarter of 2022. Then there was a crisis in which Shanghai was closed for two months due to the epidemic, resulting in negative growth of China's GDP in the second quarter. Fortunately, GDP rebounded by 3.9% in the third quarter. Although the economy has resumed its growth trend, the slow growth of consumption and exports are making it difficult for the Chinese government to achieve its annual economic growth target of 5.5% this year. Among the three key factors driving China's economic growth, as the epidemic-related lockdown restrictions hamper consumption, while China's exports face challenges from the reopening of other countries and worsening global stagflation, investment is regarded as the only pillar. In the context of the economic downturn, fiscal spending is the focus of work, and overall infrastructure investment will grow by about 8-9% in 2022, the fastest growth rate since 2017.

The outside world generally does not doubt China's ability to control economic fluctuations in the short-term, but there is not much confidence about whether China can achieve a balance between Zero-COVID policy and economic development, because this involves President Xi Jinping's long-term concept of governing the country. It serves as the basis for Xi's belief in the superiority of the Chinese system. The strategic containment pressure exerted by the United States from the outside may allow him to use the power of nationalism to consolidate his leadership position, but the state-led economic growth model it has gradually shaped will provide space for rent-seeking and monopoly of state-owned enterprises. Suppressing the vitality of innovation and development of private enterprises is not conducive to long-term economic growth and common prosperity. **KIEP**