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Opinions

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China's Economic Reform and Risks

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At the 2014 National People's Congress (NPC), Premier Li Keqiang mentioned the word "reform" 77 times. It was also used 721 times at the National People's Congress in the last 10 years, more than any other word. Indeed, reform has been a hot economic issue even during past regimes, and it is not a concept that suddenly emerged. Despite this, the intensification of reform this year has a special meaning. If the reform of 30 years ago was aimed at resolving ideological issues, the reform of today seeks to address the benefits of various classes that comprise the Chinese economy. As Wang Yang said, reform is an extremely painful process, one which requires the determination to cut off a limb poisoned by a snake bite.

The current Chinese economy is facing the need to pursue economic reform. Now is the time to address the risks inherent in Chinese economy without delay. The third-generation leaders led by Jiang Zemin and Zhu Rongji concentrated on audacious reforms for a decade. Hu Jintao's fourth-generation leadership was successful in economic growth, thanks in large part to such economic reforms. However, due in large part to focusing too much on growth, reform was relatively overlooked. The political reform touted by Wen Jiabao was slow in coming and lost the window of opportunity whilst implementing economic recovery measures through investments in an effort to overcome the 2008 global financial crisis. Xi Jinping's fifth-generation leadership inherited power that was limited in policy making because of the side effects of the leadership's economic recovery measures.

At National People's Congress held in March 2013, President Xi Jinping promised in his emotional speech that he will make the "Chinese Dream" come true. The Chinese Dream he was referring to can be thought of as building a strong and wealthy country as a revival of the Sinocentrism as well as the Chinese people's growth and happiness. Economic reform is a means of realizing that Chinese Dream. As ground works for an all-out economic reform, the country has pursued anticorruption and announced the reform of the super-ministry system, a proposal for government restructuring. Based on this, the Third Plenary Session of the 18th Central Committee of the Communist Party of China proposed the blue print for reform through "the Decision on major issues concerning comprehensively deepening reforms."

Specific policies for economic reform for the next 10 years began to be announced since the 2014 National People's Congress. Growth with stability was the fundamental economic policy for 4 consecutive years since 2011. This is because the economic policy is being determined within the large framework of the 12th Five-Year Plan (2011–2015), which the current leadership inherited from Hu Jintao's fourth-generation leadership. One change, however, is the advent of the phase "innovative reform" alongside "growth with stability." With this, the new leadership seems ready to pursue a full-fledged economic reform which is based on economic stability. That is to say, it will put weight on reform while seeking stability and reform at the same time. It appears that the economic reform direction of the fifth-generation leadership will be clearer than the 13th Five-Year Plan (2016–2020).

The problem is that such intensification of economic policy could run into conflict with the risks inherent in the existing Chinese economy. For instance, the anticorruption laws implemented last year for social stability dampened consumption and brought on short-term slowdown of growth. Because of the staggering forward investments, the debts of local governments that made investments when the marginal utility of investment had already worsened ballooned. In order to address the excessive local government debts, the national development and reform committee (NDRC) had warned at the National People's Congress that overaggressive investments shunned in light of the proposed flexible growth rate of 7.5%. With the restrained investment by the local government, the economic growth will slow down, real estate market will decline, and real estate companies will default.

As a side effect of low interest policy for convenient investment, the so-called “shadow finance” started to grow. Through financial reform, the Chinese government is seeking to change the investment mechanism itself, breaking the monopoly of the state-owned banks through interest rate liberalization. In other words, it will ensure efficient investments where invisible hands of the market take center stage. Excess will be discouraged while default of some companies will be tolerated, and without the deposit protection insurance in place as yet, China is likely to experience a great deal of trial and error.

In order to discourage excessive production, the National People's Congress even suggested specific reduction target for the year 2014, such as 27 million metric tons of steel, 42 million metric tons of cement, and 35 million standard containers of plate glass. In the future, corporate default will be tolerated and industrial restructuring will take place in relevant industries. Rapid aging of the Chinese society because of the one-child policy is another major problem; population growth without a mature registration system or social security program may give rise to other side effects.

Although there is high likelihood that economic reform and potential risks will run into each other, there are also many positive elements. Lou Jiwei, the Minister of Finance, stated that 7.2–7.3% growth rate comports with the target and that employment is more important than achieving the target. The number of new jobs is rising despite the slowed growth, adding one million new jobs to the target from last year's. The ratio of service jobs relative to the GDP exceeded manufacturing jobs for the first time, becoming a potential new growth engine for the future.

There is a high likelihood that policy risks will surface in various areas because of the intensification of economic reform. We will continue hearing about economic crisis because of shadow financing, the possible of hard landing as a result of slowed economy, corporate defaults, and resistance from and conflicts with the established class. There will be metastasizing of such risks to other areas. However, these are outcomes that will occur while encouraging the decisive role of the market as suggested at the Third Plenary Session of the 18th Central Committee of the Communist Party of China. It appears, too, that there will not be any serious hard landing of the Chinese economy any time soon. Forecast based on the degree of implementation of the anticorruption laws, the intensification of the future economic reforms could occur faster than we think.

Economic crisis can take place suddenly without any warning. This is because we are already prepared to take on preventable crises through various measures. This is why China's crisis could suddenly erupt because of social or political instabilities rather than the economic factors discussed here. Therefore, it is necessary to reinforce continuous monitoring of the possibility of simultaneous economic crisis as well as social and political factors. If China succeeds in economic reform without experiencing the policy risks caused by economic reform discussed above, one can only imagine what China, led by the sixth-generation leadership, would be like. KIEP