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## China's economic policy dilemma

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Bonn, 5 November 2012. China is dividing. What was apparent in Germany from the recent debate surrounding the award of the Nobel Prize for Literature and the Peace Prize of the German Book Trade also applies to economic policy. Like no other country, the People's Republic seems to invite highly optimistic forecasts and collapse scenarios at one and the same time. In 2009 China was portrayed as the saviour in the global financial crisis, but now that the growth of its gross national product is weakening, the system is almost expected to collapse again. Given these extremes of opinion, it is not easy to maintain an objective view of China's current economic situation.

A number of factors are contributing to the extremes of opinion. For one thing, China is large. What sounds like a truism nonetheless carries some weight in an assessment of the country's overall economic and political situation. It is possible, for example, for the real estate market in an eastern Chinese city like Wenzhou – symbol of the successes of China's private sector – to falter and create difficulties locally for the banks and the government, while the same market continues to boom in regions of central China. At the same time, China is still far from transparent. Despite the wealth of statistics, business and media reports, it is often hard to find any reliable information and data. The information that is publicly available is subject to a system which has perfected not only censorship but also the art of manipulating opinion, starting with the state-decreed content of school and university education and extending to the infiltration of the discussions of online media fora. Added to this, Chinese society is divided. After 1992 there was a societal consensus: as long as the people refrained from political protest and unrest, everyone would share the benefits of the reforms. Not everyone would be rich, but everyone would be much better off. That consensus is currently in danger of rupturing in the face of corruption and environmental scandals, a loss of confidence in food safety, scandals connected with the dispossession of farmers for the sake of building projects, general dissatisfaction with the education system, a persistently wide income gap and information on the im-

mense wealth of the families of leading government figures. All this encourages the impression that policy cannot, or can no longer, guarantee consensus. Not the least important factor is that the economic system is split. The reforms undertaken since 1978 have put an end to the planned economy, and private businesses have made a significant contribution to the successes of the past 30 years. Despite this, central and local government wields considerable influence over the economy. In China it is said openly (and often bitterly) that in the last few years state-owned enterprises have again begun playing a more dominant role in the economy, while the private sector has been pushed aside. Under the more recent economic policy the state has again been more active in controlling industries and investments and in so steering competition. This is especially true of the "strategic" industries. China therefore makes a distinction between the part of the economy that is "inside the system" (state-owned enterprises, strategic industries, the civil and public service, etc.) and the part that is "outside the system" (private businesses, many export-oriented manufacturing industries, the informal sector, farming, the unemployed, etc.).

Insufficient account is taken of these factors in economic figures used for international comparisons. This is true, for example, of the wide-ranging and, at the time, internationally applauded 2009 economic stimulus programme, which led to a rapid increase in lending by the state-owned banks. How this policy is rated now very much depends on the extent to which the aforementioned aspects of the Chinese system are considered: did the loans go primarily to prestige projects set up by local authorities? Was the local private sector supported? Was economically appropriate investment effected? How great is the risk of banks facing serious loan losses in the future? Opinions on these aspects differ: while the programme financed, for example, the expansion of the high-speed railway network and so improved transport links between many cities, the Ministry of Railways has recently been beset by corruption scandals, a serious accident in 2011 has led to the maturity of Chinese high-speed trains being questioned, and track problems mean that trains today travel at well below target speeds.

With the government having yet to draw up a new, comprehensive stimulus programme this year, despite the weakness of the economy, it is difficult to assess the situation: is this a good sign, indicating that the government has recognised the risks associated with the policy pursued in 2009 and intends to place greater confidence in market forces again? Or is it a bad sign, merely reflecting the lack of agreement within the government at a time of political transition?

These questions show that the major challenges facing China's economic policy are of a regulative rather than an economic nature. For some time now the government has been emphasising China's need for a new growth model. In an aging society and with factor prices rising, a model based on export-oriented, labour-intensive production no longer augurs so well. Innovation, a knowledge-based society and green growth are the goals for the future. So far the government has relied primarily on industrial policy instru-

ments and state control to bring this change about. But there are some indications that a new growth model cannot be achieved without a new economic order, one that promotes transparency and fair competition and is based on an education system that makes creativity, free thinking and dissent possible. The dilemma facing Chinese policy (and politicians) is that, while an economic order of this kind appears important for China's continued economic development, it will also threaten the continued existence of the political order and the privileges of the present elites.

This week will see the 18th Party Congress and the appointment of the country's new political leaders. The candidates for the reins of power in China are known. Precisely what policy they will pursue will emerge only in the next few years. The rest of the world can but hope that the new leaders find a way to cushion the consequences of the financial crisis without delaying the decisions on the political and economic order unnecessarily.



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