Rethinking the Next China

Yale University | Stephen Roach | 25 March 2017

For the past seven years, I have taught a popular class at Yale, called "The Next China". From the start, the focus has been on the transitional imperatives of the modern Chinese economy – namely, the shift from a long-successful producer model to one driven increasingly by household consumption. Considerable attention is devoted to the risks and opportunities of this rebalancing – and to the related consequences for sustainable Chinese development and the broader global economy.

While many of the key building blocks of China's transitional framework have fallen into place – especially rapid growth in services and accelerated urbanisation – there can be no mistaking a new and important twist. China now appears to be changing from an adapter to a driver of globalisation.

In effect, the Next China is upping the ante on its connection to an increasingly integrated world, and creating a new set of risks and opportunities along the way.

The handwriting has been on the wall for several years. This strategic shift is very much a reflection of the leadership imprint of President Xi Jinping – in particular, his focus on the "China Dream". Initially, the dream was something of a nationalist mantra, framed as a rejuvenation by which China would recapture its former position of global prominence, commensurate with its status as the world's second largest economy.

But now the China Dream is taking shape as a concrete plan of action, centered on China's One Belt, One Road (OBOR) plan. This ambitious pan-regional infrastructure initiative combines economic assistance with geostrategic power projection, supported by a new set of China-centric financial institutions – the Asian Infrastructure Investment Bank (AIIB), the New (BRICS) Development Bank, and the Silk Road Fund.

For those of us studying China's economic transformation, this is hardly a trivial development. While the shift remains a work in progress, I would stress three tentative implications.

First, China has not made a full about-face.

As an economist, I am prone to placing too much emphasis on models and on the related presumption that policymakers can flip the switch from one model to another. Yet it is not that black and white – for China or for any other country.

China's leaders have, for all practical purposes, now conceded that a consumer-led growth strategy is tougher to pull off than originally thought. The consumption share of GDP has

risen just 2.5 percentage points since 2010 – far short of the boost to personal incomes that might be expected from the 7.5 percentage-point increase in the share of services and a 7.3 percentage-point increase in the high-wage urban share of its population over the same period.

This disconnect largely reflects a porous social safety net that continues to foster high levels of fear-driven precautionary saving, inhibiting the growth of discretionary consumption. While still committed to urbanisation and services development, China has elected to draw on a new external source of growth to compensate for a shortfall of internal demand.

Second, this global push has many of the features of the old producer model.

It enables an increasingly worrisome overhang of domestic excess capacity to be directed at OBOR's infrastructure requirements. And, it relies on state-owned enterprises (SOEs) to drive that investment, forestalling long-needed reforms in this bloated segment of Chinese industry.

The flip side of this newfound support for the producer model has been a de-prioritisation of consumer-led growth. In Prime Minister Li Keqiang's annual Work Report – the official statement of economic policy – emphasis on the consumer-led structural transformation has been downgraded in each of the last two years (ranked third in both 2016 and 2017, as so-called supply-side initiatives have gained higher priority).

Third, China's new global approach reflects a recasting of governance.

Xi's consolidation of domestic power is only part of the story. The shift in economic decision-making away from the State Council's National Development and Reform Commission (NDRC) toward Party-based Leading Small Groups is particularly important, as are the anti-corruption campaign, heightened Internet censorship, and new regulations on non-governmental organisations (NGOs).

The irony of such power centralisation is unmistakable. After all, Xi issued early promises to break up deeply entrenched power blocs, and the Third Plenum reforms of November 2013 emphasised the promotion of a more decisive role for markets.

But there is an even deeper irony for China's new global push. It runs against the grain of a populist anti-globalisation backlash that is brewing in many developed countries. As a producer-focused economy, China has long been the greatest beneficiary of globalisation – both in terms of export-led growth and poverty reduction stemming from the absorption of surplus labor. That approach has now been stymied by China's mounting internal imbalances, a post-crisis slowdown in global trade, and an increase in China-focused protectionism. As a result, China's new attempts to gain increased leverage from globalisation are not without serious challenges of their own.

A more global China also has important ramifications for Chinese foreign policy. Territorial disputes in the South China Sea loom particularly large, but China's footprints in Africa and

Latin America are also drawing heightened scrutiny. This new strategy raises perhaps the biggest issue of all – whether China fills a hegemonic void created by the isolationist "America first" approach of US President Donald Trump.

In short, the Next China is shaping up to be more outwardly focused, more assertive, and more power-centric than I envisioned when I started teaching this course in 2010. At the same time, there appears to be less commitment to a market-based reform agenda featuring private consumption and SOE restructuring.

The jury is out on whether this changes the final destination of Chinese rebalancing. I hope that is not the case. But that is what makes it more interesting to teach an applied course, where the focus is always a moving target.

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