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# More Market and More State: China's Economic Development in the New Five-Year Guideline

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*A new Chinese five-year plan assumes a recalibration of the country's economic model and the introduction of market-oriented structural reforms, which means more market and less state intervention. The aim of this approach is to reassure Chinese society that the economy is stable after the slowdown in 2015 and to help it avoid the "middle-income trap". Under the new plan, the economy should rely on innovation and domestic consumption. Despite these declarations, China's authorities will not end their control over the economy and investments in the production sector. This implies greater engagement of the country abroad and more efforts and pressure on the EU to grant the PRC market economy status.*

In mid-March, the Chinese parliament adopted the 13th five-year guideline, covering the period 2016-2020. Contrary to the Mao era, when the plans set strict production quotas and had to be achieved, the guidelines now play the role of roadmap for economic policy. The new plan is the first one prepared by the current leaders, who came into power three years ago. This is also the first official economic roadmap to be announced since China's economic growth hit its slowest pace in 25 years and comes after three spectacular stock market plunges in mid-2015 and early 2016. Those problems, especially the stock gyrations are perceived as leadership mistakes. Under these circumstances, the new plan is intended to reassure Chinese society that the country's economy is stable and under control, and that assumed reforms will be implemented smoothly with minor inconvenience to its citizens.

**Reform of China's Economic Development Model.** The main goal of the plan is to achieve a "moderately prosperous society", which means building up the middle class by 2020. This assumes a doubling of China's 2010 GDP per capita, which means average annual GDP growth of at least 6.5%. To achieve this aim, the plan emphasizes the core economic driver should be innovation and a need to increase the share of domestic consumption in GDP. An important element of the plan is also a focus on citizens' wellbeing as a way to reduce the propensity to save and to expand consumption.

These changes are in response to the belief that the current export-driven economic model is coming to an end. It is argued that the slower pace of economic growth requires China enact supply-side reforms. So far, the PRC's policy has been focused on the demand side, such as boosting investments and exports. Examples include a stimulus package announced in 2009 (worth about $585 billion), together with looser monetary policy that spurred lending, and cheap manufactured goods for export. This policy, though, has led to a bubble in the country's real-estate market, over-production and over-employment, especially in heavy industry, along with huge debts taken on by local governments which borrowed money for investments while often neglecting the economic efficiency of the projects. At the same time, the global economic slowdown resulted in less demand for Chinese exports. The country's level of competitiveness is dropping as its products become more expensive due to wage pressure caused by a shrinking workforce as a result of its aging society (namely because of its former "one-child" policy). These factors, when

combined, lead some to speculate that China may fall into the "middle income trap", in which a country is unable to expand incomes beyond a certain point.

This is why the new economic guideline assumes a reduction of production capacity and excess stock along with lower costs and de-leveraging. The current leaders have consistently emphasized that the market should play a "decisive" (not a "basic") role in the economy, which means that state intervention should lessen. Their plan is to create a favourable economic environment through structural reforms, rather than by stimulating the economy.

But it seems apparent that this policy, if implemented, may result in some negative side effects. For example, by closing so-called "zombie" companies (unproductive firms dependent on credit), steelworks and mines, unemployment may significantly increase. Meanwhile, state-led encouragement of individual investors to invest in stocks as a way to reduce the propensity to save, the introduction of mixed ownership of state-owned companies (SOE) and curbs on capital outflow after a stock plummets have resulted in a greater tendency for transferring money abroad. This shows a lack of confidence in the Chinese economy.

**State Intervention for the Sake of a Market Economy.** Chinese leaders have eventually accepted the fact that the era of double-digit GDP growth is over. But the new plan, as well as last year's "zig-zag" response to the gyrating stock market, together with putting on hold the "no bailout" policy to tackle local government debt and lagging reform of SOEs, may indicate that there is uncertainty at the top about recalibrating China's economic model.

Chinese leaders who are accustomed to state control over the economy might feel unease about giving the market a free hand. In that sense, there is the possibility that leader Xi Jinping will be more prone to maintain control over the economy for the sake of stability and Communist Party (CPC) legitimacy. Under these circumstances, the leaders may pursue reforms simultaneously with strengthening the role of a "visible market hand", such as a stimulus package. It is argued that the assumed annual GDP growth cannot be achieved without stimulus, but this growth is indispensable if the plan's main goal is to be accomplished as scheduled ahead of the100$^{th}$ anniversary of the CPC.

The plan indirectly confirms the intent to manoeuvre between state intervention and market forces. Vindication of this view might be the centralisation of decision-making and shifting of the centre of economic policy from the state (prime minister) to the party, especially to the two economic task forces headed by Xi. This step gives him room for manoeuvre, as the party is more flexible than the state apparatus, which is restricted by China's constitution. It is worth mentioning that the guideline assumes huge infrastructure projects, which, to some extent, are a form of stimulus package. The document enumerates investments for the next five years, including thousands of kilometres of high-speed railways and highways and more than 50 new airports.

The recent developments in China's economy seem to confirm this balanced approach ("neither too tight nor too loose"). On the one hand, a decision was announced to decrease production of steel and restructure employment in heavy industry (officially it affects about 2 million people) but, on the other hand, China is aggressively promoting its "Belt and Road" initiative to export its overproduction. At the same time, the country is more boldly using fiscal and monetary policy. For example, the central bank continues to pump money into the market (e.g., a recent RMB 180 billion net injection) to maintain liquidity and encourage financial institutions to issue credit to boost consumption. China is also in the process of setting up its own economic mechanisms, such as measures to prevent the outflow of capital and the central bank's decision to create a Chinese digital currency (a Chinese "bitcoin").

**Conclusions.** Without access to reliable data about China's economy, and bearing in mind the fact that the planned reforms are unprecedented, it is difficult to predict the next five years of the Chinese economy. It seems that the country's leadership is aware that the reforms should be introduced to avoid a hard landing, but uncertainty about the consequences might be reason enough for Xi to take on greater control of the economy. Supposedly, he will be continuing the experimental approach, which means that the reforms will be introduced with the possibility to put them on hold if needed. Centralisation might also help keep control over Chinese society to prevent potential expressions of discontent about the economic situation.

Despite the slowdown, and even anticipating lower than planned GDP growth, it seems that China will remain a global economic engine for the next five years. But to do so, the PRC needs foreign markets for exports and investments (probably stimulated by RMB depreciation). What is more, the guideline assumes modernisation and increased productivity in the manufacturing sector and acquiring new technologies to introduce Chinese products to the global value chain. Europe seems to be a likely partner to help China facilitate implementation of its five-year plan, through the "Silk Road" and "Junker Plan" as instruments for greater involvement.

But to make this happen, China is already using a special opportunity that is becoming a hot topic. In December, one provision of Article 15 of China's WTO accession protocol about anti-dumping measures for imported state-subsided Chinese goods, will expire, opening a window to grant the PRC market economy status. In practical terms, it means that China will have an easier time exporting its overproduction to the EU, while for the EU (China's largest economic partner), introducing anti-dumping measures on Chinese products will be very difficult. Although the effect of granting this status is difficult to predict, there is the high possibility of an inflow of cheap Chinese imports, which might lead to higher unemployment in Europe. Granting market economy status is more a political than a technical issue, and many countries keen on maintaining good relations with China are presenting a supportive stance on granting market export status to China. The EU has not worked out a cohesive stance on it, which enables China to exert hard pressure on Europe, undermining EU leverage on China and complicating transatlantic relations.