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# China's Great Political and Economic Dilemma

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## SYNOPSIS

*The need for China to reconcile its communist political philosophy with its market-oriented economic practices, has, in recent years, created a significant paradox in its capacity to fully realise either. To attract foreign investments and to stabilise economic development, Beijing must implement rule-based frameworks while reducing government interference.*

## COMMENTARY

The collapse of the Soviet Union in 1991, and the failures of Mao Zedong's "Great Leap Forward" campaign from 1958 to 1962, during which private property and a profit-based economy were replaced with public ownership and communal control, demonstrated unequivocally the inadequacies of the communist economic model. With the dissolution of the Soviet Union, 15 former Soviet Socialist Republics were left to reconstruct their economy from scratch, and none chose communism as a model.

### The Rise of China's Economy

China's current economic success can be attributed to the late Chinese leader Deng Xiaoping, who drafted a series of documents outlining the "Four Modernisations" in 1975 and adopted the "Reform and Opening-up" policy in 1978, which was diametrically opposed to the communist economic model of the past.

Indeed, Beijing's endorsement of "capitalism with Chinese characteristics", a term first coined by Chinese Communist Party General Secretary Hu Yaobang in 1982, resulted in: (i) an 810 per cent increase in overall trade volume from 2001 to 2020, compared to a 180 per cent increase in aggregate global trade since China's accession to the World Trade Organization; (ii) an increase in GDP of more than 9,182 per cent from

1980 to 2021, compared to 751 per cent internationally; and, (iii) lifting more than 800 million Chinese people out of poverty over the past four decades.

China is now the second largest economy in the world with a GDP of more than US$17.7 trillion (2021), the world's second largest grouping of equity and bond markets, and it also accounts for the largest share of trade globally. Such unprecedented success was not the consequence of the communist economic model, but rather a variant of the capitalist economic model.

**Beijing's Economic Policies**

To be sure, China's economic reforms have not always been smooth; in fact, they have become more uncertain under President Xi Jinping, who is attempting to broaden the scope and strength of the state. Indeed, in recent years, Beijing has engaged in frequent economic policy reversals, which can be attributed to:

i) its determination to protect its communist political philosophy, which runs counter to its market-oriented economic reform policies;

ii) its propensity to increase governmental control over both the political and economic realms, which stifled private enterprise growth;

iii) its political rhetoric termed "common prosperity" to close the wealth gap among the varied social classes in China, which also runs contrary to the market-oriented mechanism; and,

iv) its preference for the rule by law, implying that decisions are imposed on citizens, as opposed to being guided by the rule of law, which regulates the state's apex lawmaking authority's unrestricted use of power.

These have resulted in lack of predictability for both the private sector and international investors.

Beijing's draconian measures to deal with the COVID-19 pandemic, including an unprecedented three-year lockdown, have stifled the country's economic progress, and caused significant hardship for its people. Moreover, Beijing's COVID laws had also led to a reduction in the activities of multinational firms, resulting in the exodus of much-needed expat talents. Indeed, Ker Gibbs, former president of the American Chamber of Commerce in China, decided to return to the US, contending that "[China's] current direction is troubling", and "It's going much more towards a more repressive, authoritarian model".

Similarly, the recent crackdown on major technology companies, and the real estate and private tuition sectors have raised serious concerns among investors. These policies have resulted in the loss of more than US$1.5 trillion in market value for Chinese technology enterprises.

The real estate sector contributes between 25 to 30 per cent of China's GDP annually. Beijing's unprecedented crackdown on the industry has not only harmed its economy, but has also impacted its local governments, banking sector, homeownership in the country, and the confidence of international investors.

Real estate developers in China lost US$90 billion in market value, and investors have priced in a massive US$130 billion loss on their offshore USD bonds, with a default rate of more than 50 per cent. With land sales accounting for more than 40 per cent of local government revenue in China, income from land sales fell by RMB 2 trillion (US$290 billion) in 2022. The country's local governments now face tremendous headwinds from more than US$9 trillion in outstanding debt, with almost one-third of major cities currently unable to meet debt payments.

Beijing's crackdowns in these sectors under the mantra of maintaining data security, fair and reasonable market competition, and egalitarianism, have sent mixed signals to both Chinese and international investors. Indeed, investors have criticised Beijing's regulatory clampdowns as "anti-capitalist" or attributed them to the Chinese Communist Party's "lust for control".

Besides these, Beijing is now attempting to gain greater influence over its private technology companies through joint ventures involving state institutions, as evidenced by recent accords between China Unicom and Tencent, China Mobile and JD.com, and China Telecom and Alibaba.

Such initiatives have come at significant costs to China's economic development, which saw the country's GDP grew by only 3 per cent in 2022, falling well short of its proclaimed objective of "about 5.5 per cent". Private firms and overseas investors have reduced or withdrawn their investments in China, resulting in the loss of private enterprise jobs. Youth unemployment has risen to above 20 per cent. Beijing's tuition centre crackdown have put more than 3 million jobs at risk, while major technology companies like Tencent and Alibaba had also laid off tens of thousands of employees.

**Restoring the Economy**

In the face of such economic and social challenges, Beijing had no choice but to adopt a series of pro-market measures in order to rectify some of the damage done. Premier Li Qiang attempted to reinvigorate the private sector by asserting that "we will create a market-oriented, legalised and internationalised business environment, treat enterprises of all types of ownership equally, protect the property rights of enterprises and the rights and interests of entrepreneurs".

Indeed, Apple CEO Tim Cook's recent meeting with Premier Li Qiang, and high-profile former Alibaba CEO Jack Ma Yun's return to China after months abroad, indicate that Beijing is loosening its grip on the private sector and is welcoming international investment.

Furthermore, Beijing has launched a comprehensive plan to rescue its real estate sector, articulated in a 16-point initiative. These initiatives range from alleviating the liquidity issues faced by developers to extending mortgage repayments to homeowners, all of which are in stark contrast to Beijing's resolute crackdown on the industry just a few years ago.

The ongoing necessity for Beijing to reconcile its communist political philosophy with its market-oriented economic aspirations presents an enormous paradox in its capacity to fully realise either. The dilemma then is whether Beijing would resume its crackdown on the private sector once the country's economy has recovered. The recurrent necessity to reverse economic policies erodes the confidence of private enterprises and international investors and jeopardises the economy.

## Rule-based Frameworks

To transition China's economy from one plagued by policy uncertainties to one characterised by market forces, Beijing will need to establish rule-based frameworks to allay the concerns of private enterprises and international investors. According to Li Daokui, the director of Tsinghua University's Academic Center for Chinese Economic Practice and Thinking, there has been a misconception that "the private economy is not the foundation of the ruling party's rule". Li added  that all enterprises – private or state-owned – should be treated on par and operate under the same law put in place by the ruling party.

Indeed, these rule-based frameworks should safeguard the integrity of its industries while facilitating the investigation and punishment of those that violate the law – all while permitting the market to chart its course. To avoid unpredictability, any irregular crackdown must be justified and in compliance with predefined standards and rules.

Beijing's stringent controls on its capital accounts and foreign exchange convertibility have also rendered international investments fraught with political uncertainty. Indeed, billionaire investor Mark Mobius has cautioned investors to "be very, very careful" after admitting that he was unable to withdraw his funds from China.

Consequently, to attract foreign investment and stabilise economic development, Beijing must implement rule-based frameworks while simultaneously reducing government interference in order to curtail political uncertainties associated with operating and investing in China.

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