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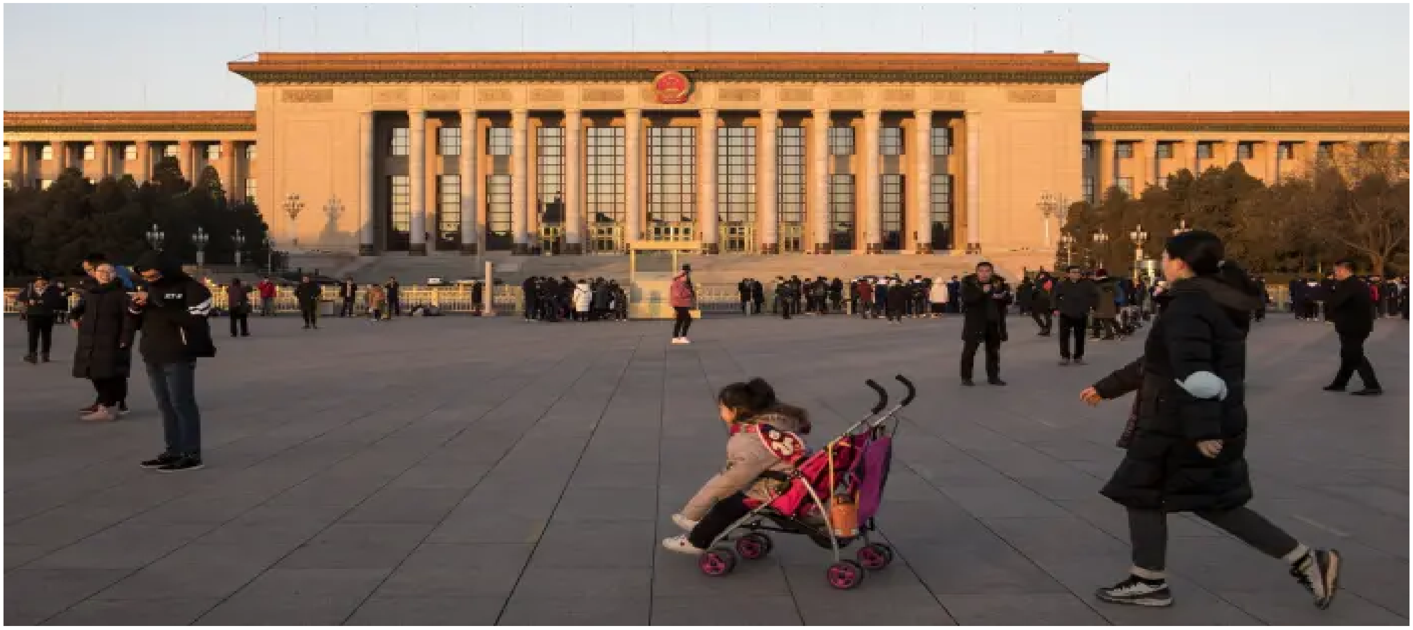
Opinion **beyondbrics**

China's slowdown is of its own doing

Blaming the trade war with the US is a dangerous mischaracterisation



The Great Hall of the People in Tiananmen Square, Beijing. The Communist party still dominates the Chinese economy © Bloomberg

Harry G. Broadman JANUARY 30, 2019

The noose around the neck of China's economy has been getting tighter, but hardly as a result of the tariffs imposed by the US. This is a dangerous myth celebrated by Washington and used as a scapegoat by Beijing.

Rather, the squeeze is largely self-induced. It stems from the lack of further reform — in some cases, the reversal of past reforms — in an economy still heavily dominated by the state and whose largest enterprises remain governed by the Communist party. The power to alter China's economic fortunes lies largely in Beijing's own hands.

The overarching symptom is a secular fall in China's real GDP growth. Except for an upward blip in 2010, the growth rate of the Chinese economy has been on a steady decline over the past 10 years. Such a pattern cannot be the result of China's trade war with the US, which began in earnest only last year. And, despite the US imposition of tariffs, China's trade surplus has expanded, not contracted.

The trend continues. Last week, Beijing announced that its official recording of real GDP growth for 2018 was 6.6 per cent, the lowest rate China has experienced since 1990, the year following the student protests in Tiananmen Square. Beijing downplayed the news, casting it as fully in line with the government's forecast for 2018 and a sign of the maturity of the Chinese economy.

Those of us who have worked on the ground in China for decades, however, know full well that even if one takes the country's official economic statistics at face value (which few of us do), the exercise Beijing utilises to set its growth projections lacks rigour and is tinged by political imperatives.

Worse, the process is almost a tautology: official forecasts for a given year are not released before the year's start. Thus, only this March will Beijing unveil 2019's projection — that is, after a quarter of the year has already passed. That's a sure-fire way of improving the accuracy of any forecast.

As to China being a mature economy, it's highly doubtful whether the majority of the country's citizenry would agree with Beijing's characterisation. While a number of reforms put in place since 1978 — some of which have been truly ingenious — have lifted millions out of poverty, many Chinese remain poor by any standard. On a purchasing-power-parity basis, China's per capita GDP is below the global average. It is on par with countries such as Serbia, the Dominican Republic and Botswana — countries whose economies don't leap to mind as being mature.

If a precursor to economic maturity is sustained high growth that is widely diffused nationally — no small feat for a country that has a large population and occupies a vast geographic space — China is moving in the opposite direction. Indeed, the IMF forecasts China's growth to continue to fall, to 6.2 per cent for 2019 and 2020.

By way of comparison, consider India, the other Asian giant with comparable characteristics to China and widely considered to be in an economic race with China to reach maturity. India's growth in 2017 was below that of China, exceeded it in 2018 (at 7.3 per cent) and, the IMF predicts, will speed up to 7.5 per cent in 2019 and 7.7 per cent in 2020. Unlike China's, India's growth trajectory is upwards. Neither country is close to being mature, but India — at least at the moment — is looking more sure-footed than China in this regard.

What is at the core of China's growth problem? Simply put, it's the contradiction inherent in the country's self-titled, oxymoronic "socialist market economy" programme, initially launched by Deng Xiaoping and formally enshrined in 1992.

At its roots, China is not a market-based economy. Its separation of business and government remains ephemeral. Property rights are ill-defined and unenforceable, providing strong incentives for corruption. Identification of beneficial owner(s) and of who has ultimate control over decisions in some of the country's key enterprises is opaque. The large state-owned banks hold little check, if any, over the large, backbone state-owned enterprises (SOEs) to whom they lend, and which often never pay off debts owed. Communist party officials occupy some of the most senior positions in the enterprise and financial sectors, including the recent appointment of the country's top banking regulator as party chief and deputy governor of the central bank.

As well as all that there is a Potemkin non-state enterprise sector (often referred to as the "private" sector), which some well-respected China analysts a few years ago thought was on a sustainable growth path and would potentially overtake the SOEs' role in the Chinese economy. But they were confused by *cyclical* aberrations (a bit of irrational exuberance) to a cemented *secular* trend of SOE dominance. In the past, the authorities worked to facilitate bank lending to the non-state sector. This year, there has been a return of the constraints placed on shadow banking, which is ossifying the flow of credit and raising funding costs to small and medium-sized private companies.

The socialist market economy paradigm is a stark illustration that the Chinese are trying to have their cake and eat it too. The rub is that SOEs constitute the Communist party's *raison d'être*.

Perhaps the clearest sign of China's self-inflicted ball and chain on growth is how global investors have been shunning foreign direct investment in the country. Between 2013 and 2017 — long before the onset of the trade war with the US — worldwide net FDI inflows to China fell steadily. Indeed, their magnitude in 2017, at $168bn, was below where they stood in 2008, at $172bn. Since annual net FDI inflows can be quite variable, measuring them as a share of GDP gives a more accurate depiction. This yields a particularly sobering picture: China's net FDI inflows relative to GDP have been on an unmistakable downward trend, from 6.2 per cent in 1993 to 1.4 per cent in 2017, the lowest level since 1991.

To help rectify this problem, Beijing is trying to pass a new foreign investment law this year. The draft presently under debate was first unveiled in 2015. That fact alone illustrates that it has not been, and may still not be, an easy task to bring the party around to opening up the domestic economy as a means of generating new opportunities for growth.

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