The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

China's New Reforms in Theory and Practice

By William Overholt

November 27, 2013

On Nov. 12, the Third Plenary of the 18th Central Committee of the Chinese Communist Party announced a major turn to market-oriented policies: interest-rate and currency liberalization, reform of banks and state enterprises, clearer land ownership for rural inhabitants, and a better deal for urban migrants.

Behind this landmark decision was a potential crisis. China's success has been driven by cheap exports based on cheap labor, infrastructure built by state enterprises with low-cost bank funding, and government budgets funded by land sales. But labor is no longer cheap, road construction to connect major cities has given way to building large shopping malls in small towns, and land sales based on re-zoning are reaching both economic limits and the limits of villagers' tolerance.

Cheap money with limited investment outlets now risks fueling property bubbles and industrial overcapacity. Without fundamental change, China faces slower economic growth, inadequate job creation and innovation, and popping bubbles.

The solution is a rapid shift from China's export-based growth model to one based on domestic demand; from infrastructure to consumption; from the dominance of large state-owned enterprises to that of small and medium-size private enterprises; from industry to services; and, more broadly, from bureaucratic control to market control.

All successful Asian countries have made this shift; South Korea and Taiwan are models. But rapid change entails immense pain. State-owned enterprises will lose their low-interest loans, subsidized land, monopoly protection, and privileged housing. Party and state bureaucracies will lose power and income.

Local governments are particularly desperate. They have huge debts, which they amortize by re-zoning and selling land. Already squeezed by exorbitant property prices and popular resistance to land takings, they now face higher interest rates, property taxes, villagers empowered by stronger rights, and expensive new requirements to provide social services to migrants. The desperation of local potentates and state-owned enterprise executives has created powerful resistance to reform.

At a plenary reportedly marked by acrimony, China's political leaders sided with reform. As one economic planner said, when asked about resistance before the decisive meeting, "In the end, all of our leaders understand numbers. The implications of the numbers are clear."

The Third Plenum's announcement of its decisions took the form of a statement of broad principles, leaving many observers concerned by the lack of detail. But the Chinese Communist Party's role is to set the direction of policy; executing the Party's decisions is the government's job. And the plenum did establish a top-level group to coordinate and enforce implementation of its decisions.

While implementation will be a long struggle, with occasionally fierce resistance, key reforms are already underway. The current 12th Five-Year Plan calls for annual wage increases to average at least 13.4 percent. This year, wages are rising at an average rate of 18 percent, which will squeeze out industries characterized by obsolescence or overcapacity. Moreover, the government's anti-corruption campaign is targeting some of the most powerful industry groups, such as the petroleum faction, thereby weakening their resistance to reform.

Most important, economic outcomes are becoming increasingly aligned with the authorities' goals. Services already account for more output and employment than industry — the Internet company Alibaba, for example, is empowering both consumers and smaller companies on a previously unimaginable scale — and recent growth has been driven by domestic demand rather than net exports. Reform is not just a plan; it is already happening.

Economic openings to Central Asia and the Association of Southeastern Nations, specifically to Vietnam, are well under way, and reform will include further international opening. The Third Plenum's decisions follow the launch in September of the Shanghai Free-Trade Zone, which will open new sectors to foreign investment and permit largely market-based financial transactions and capital flows. The liberalization of capital flows is intended to be a gradual national policy, channeled through trusted institutions in Shanghai.

For trade in goods, the new free-trade zone is intended to compete directly with Singapore and Hong Kong. China fears dependence on those entrepots in the event of conflict. For foreign investors, the policy will be to expand greatly the range of opportunities while curtailing foreign control. Foreign companies, for example, may hold minority stakes in the telecoms sector, while dominant foreign companies like Monsanto will face constraints.

President Xi Jinping faces the politically risky task of pushing the Chinese Communist Party's reform agenda against fierce opposition while the economy slows. By emphasizing Party control — through a crackdown on state-owned enterprises' government opponents, and critics in the media and academia — Xi seeks to maximize his ability to impose economic reforms while minimizing the risk of a challenge from conservative forces.

Above all, he is determined to avoid the fate of previous Chinese leaders like Hu Yaobang and Zhao Ziyang, who lost their jobs after a critical mass of their opponents came to believe that economic and political reform jeopardized Party control. So, at least for now, China will focus on another great wave of economic reform, whereas political reform will mostly be limited to reorganization of government agencies to boost efficiency and strengthen efforts to reduce corruption. (There have been some steps toward reform, including a decision to remove judges from local political control.)

And yet China will find it increasingly difficult to postpone stronger measures that would appease popular demands for fairness, including the establishment of an independent judiciary, which could prove to be no less an imperative than structural economic reforms. Likewise, the leaders must either accept much of the information revolution's swamping of controls or engage in far more costly repression.

Hopes for political reform rest on the possibility that Xi's second term will see the accession to top leadership of reformers like Politburo member Wang Yang and Vice President Li Yuanchao. For now, however, China will focus on another great wave of economic reform.

William Overholt is a senior fellow at the Fung Global Institute and the Harvard University Asia Center. © Project Syndicate

The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.

Original url:
https://www.themoscowtimes.com/2013/11/27/chinas-new-reforms-in-theory-and-practice-a29998