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China's 'Two Sessions' paper over cracks in a troubled economy

By George Magnus

The 'Two Sessions' held in the People's Republic of China (PRC) at the start of last month – explained by Charles Parton – had the major objective of ensuring a smooth glide path towards the Chinese Communisty Party (CCP)'s 20th Party Congress, scheduled for October or November this year.

The backdrop to the 'Two Sessions' had not really changed since the Central Economic Work Conference (CEWC) that took place in December 2021, and indeed, the economic documents presented earlier this month – the Government Work Report (GWR), the National Development and Reform Commission report, and the Budget report – all borrowed heavily phrases and text from the December assessment. The typical structure of these reports comprises a lengthy self-congratulatory preamble about how and how far last year's goals were all met, followed by an equally lengthy list of tasks and goals which will be accomplished in the year to come to keep the PRC on track to meet its ambitious medium-to long-run objectives.

Problems are not ignored but are generally given short shrift, and there is no attempt to draw the reader or listener into a discussion about how they might be addressed, and the costs and benefits of alternative remedial methods. It is in this context that this year's economic goals and targets are best judged because even the best laid plans of the CCP can sometimes go astray if the economy refuses to do what politicians otherwise assert or want.

This Explainer will look at the economic and policy backdrop to the 'Two Sessions', the main points and policies arising from the economic reports that were presented by the CCP, and the degree to which the main economic challenges facing the PRC are being addressed or overshadowed by other, more political concerns.

Essential backdrop, important omissions

Consider then by way of backdrop, the status of the Chinese economy as the 'Two Sessions' occurred. Specifically:

- The PRC's economy finished 2021 with an officially measured growth rate of 4% as it continued to slow down, both structurally and in the wake of the 2020 Covid-19 recovery;[1]
- The deadweight of excessive debt, the consequences of a rapidly ageing population and shrinking workforce, and the stall in productivity growth continue to present as important drags on the economy;
- A tipping point in the real-estate sector, by far the largest sectoral contributor to the economy estimated at between 22%-29% of Gross Domestic Product (GDP),[2] was reached in 2021 and from which no durable recovery is predicted;
- A massive change in governance is occurring in which the dynamism of the private sector and growth is being undermined. This is evident in both the recalibration of industrial policy, seeking to emphasise still further the dominance of state-owned enterprises (SOEs) at the expense of the private sector, and in the 'common prosperity' campaign, featuring, among other things, increasingly politicised regulation as a way of bringing private firms and entrepreneurs to heel;
- Slower economic growth is in and of itself no bad thing, especially in the PRC's case where, say 5% of today's US$17 trillion GDP is bigger than 10% of its $7.5 trillion GDP in 2011.[3] Yet, the Chinese economy is also

[1] Orange Wang, Andrew Mullen and Frank Tang, 'China GDP: economic slowdown underlined in fourth quarter, but 2021 beat growth target', *South China Morning Post*, 17/01/2022, https://bit.ly/3JbeZkc (checked: 06/04/2022).
[2] Kenneth Rogoff and Yuanchen Yang, 'Has China's Housing Production Peaked?', *China and the World Economy*, 21:1 (2021).
[3] Author's calculation.

> unbalanced, over-leveraged, poorly structured so as to favour over-investment and misallocation, and total factor productivity growth has pretty much stopped.

Partially in recognition of some of these problems, the CEWC and this year's 'Two Sessions' economic reports noted that the PRC was facing a world in which global economic recovery had lost momentum, and that at home, the Chinese economy was struggling against pressures arising from shrinking demand, supply shocks, and flagging market expectations. Below is an assessment of whether the CCP set out proposals to deal with these problems.

It should also be noted that in the 'Two Sessions' reports and in the press conferences that took place:

- There were *no mentions* or references at all of Russia's renewed invasion of Ukraine, certainly not in the released documents which were finalised before the event, but not even in the press conferences. At the very least, the surge in food, energy, and commodity prices is going to cause Chinese inflation to rise this year, along with a GDP-sapping rise in the value of imports, negative effects on demand from higher costs and prices and weaker exports as rest-of-word demand for Chinese exports weakens. The net effects are hard to measure, and unknown as to their longevity, but whatever pedestrian growth numbers may have been pencilled in for 2020, the war will now have probably lowered them by about 1% point, perhaps more;
- There were only *patchy mentions* of the resurgent prevalence of Covid-19, which by Chinese standards remains quite low, considered globally, but over 70,000 infections in the first three weeks of March and the highest daily caseloads since the original outbreak in Wuhan have underlined how vulnerable the PRC's sensitive service sector is to the lockdowns and restrictions associated with the CCP's zero Covid-19 policy.[4] Accordingly, provinces generating more than 40% of Chinese GDP are reporting high caseloads and locking down – double the share during the Delta wave in the summer of 2021;[5]
- There were sparse mentions of the important campaign slogan, 'common prosperity', which had been strongly emphasised and discussed in 2021, almost a new doctrine for economic and spiritual renewal. This does not make it a new economic development model, which the PRC needs, but in

[4] Zhao Yusha, Liu Caiyu and Du Qiongfang, 'China toughens up to battle COVID as local cases surpass 70k in mainland since March', *Global Times*, 29/03/2022, https://bit.ly/38w3RSr (checked: 06/04/2022).
[5] Julian Evans-Pritchard, 'Covid-19 derails China's domestic recovery yet again', *Capital Economics*, 16/03/2022, https://bit.ly/3KdWwF6 (checked: 06/04/2022).

some respects it has or had claims to present programmes that would be relevant.

'Two Sessions' economics from the inside

Reading along and in between the lines of the 'Two Sessions' documents, there is a markedly less optimistic view about the economy than anything you can actually read in print.

The CCP target for GDP growth in 2022 is 5.5%, which looks low set against the experience of the last 20-25 years, but is quite ambitious bearing in mind the starting point, the headwinds facing the economy, and the PRC's low potential growth which may be little more than 2-3%.[6]

Further, GDP in the PRC is not the same as it is in other countries, because whereas most measure economic output as an outcome of spending decisions by households, firms and the government, the PRC sets GDP as a target that has to be achieved by tapping the capacity of local governments to manufacture or massage growth. This is extremely important when analysing Chinese GDP as this system of measurement is so different to other countries.[7]

There is perhaps a little cheerleading surrounding the establishment of this growth target. Li Keqiang, Premier of the PRC, made clear in his press conference that in the domestic economy, the PRC still faced some important shortcomings. It had:

- Yet to boost domestic investment momentum and lay the foundations for sustainable investment in manufacturing;
- Not compensated for the slowdown in investment and land acquisition acreage in real estate;
- Not yet addressed some serious disturbances in local governments, some of which were experiencing decreases in revenues from land sales and were unable to provide adequate funding for public goods and services, and even civil servants' salaries;
- Urgently to address structural shortages, in the supply of coal, electricity, oil and gas, semiconductors, and shipping containers.[8]

[6] Author's estimate.
[7] Michael Pettis, 'The GDP of Bridges to Nowhere', Carnegie Endowment for International Peace, 25/01/2018, https://bit.ly/3x5M5zv (checked: 06/04/2022).
[8] 'Premier Li Keqiang Meets the Press: Full Transcript of Questions and Answers', State Council of the PRC, 11/03/2022, https://bit.ly/3KfuwAP (checked: 06/04/2022).

If these verbal warnings of growth caution needed corroboration, it could be found in the Budget report which sets out fiscal targets for 2022 as a share of GDP and in trillions of yuan. Since the size of GDP from the GWR is known, it is a simple exercise to calculate the numbers assumed by the CCP for the change in the money value of GDP, or nominal GDP, which turns out to be a rise of 5-6%, almost the same as the target for real, or inflation adjusted, GDP.[9]

In other words the CCP is either predicting no inflation in 2022, which is not the case – the target is (often) 3% but it may be higher – or it is actually expecting real GDP growth to be significantly weaker than 5.5%, and to end up having to massage the headline numbers so the target can be shown to have been met. The maths here are not science, and it could be that there are other explanations for weaker nominal GDP growth, but the main message the numbers send is one of low growth expectations.

Jobs, jobs, and tech jobs

The CCP could of course act to try and strengthen economic growth artificially, as it has many times before, but it seems quite determined not to repeat the über-stimulus which has been a ticket to excessive credit creation and misallocation of capital.[10] Perhaps if the jobs picture were to deteriorate badly, the CCP's hand would be forced.

Employment has the highest priority in all of the CCP's thinking, and has done for some time. It aims to create 11 million new jobs in 2022, the same as for the last handful of years except for years affected by Covid-19. The target is a gross figure, and does not take account of people leaving the labour force, something which is happening increasingly now that ageing is taking its toll on the working age population, and women are leaving work to care for elderly relatives and so on. The CCP is ever more sensitive to these things, as well as:

- The 10.5 million or so graduates coming into the labour market each year;
- The employment travails of the PRC's 300 million migrant workers, the bulk of whom do not have urban hukou' (home registration) and who therefore are not eligible for free public goods and services, and;

[9] Li Keqiang, 'Full Text: Report on the Work of the Government', State Council of the PRC, 12/03/2022, https://bit.ly/3uTHWMx (checked: 06/04/2022).
[10] Emilia M. Jurzyk, Cian Ruane and Helge Berger, 'Resource Misallocation Among Listed Firms in China: The Evolving Role of State-Owned Enterprises', *IMF Working Papers*, 75 (2021).

- The deterioration in the quality of jobs as the fall in well paid, and skilled manufacturing and construction jobs, is being offset by the strong rise in the informal economy of low pay, low skill employment.[11]

Now, and newly arrived, so to speak, come reports that Alibaba, with about a quarter of million employees, Tencent and Bytedance, each with well over 100,000 people, and numerous other internet platforms, are on the verge of cutting between 10-15% of their payrolls.[12] These platforms are at the centre of the 'gig economy' with a workforce of over 200 million, placing tens of millions of jobs on the line – or about one in four workers generally.[13] These employees populate the fintech, education, housing ride-hailing, home delivery, live streaming, and content generation sectors, for example. It is quite possible that much pressure will be brought on firms not to lay off workers fast or in huge quantities for the time being, given how important it is politically between now and the CCP Congress, but even so, the loss of jobs in this area, hitherto a key growth area, will sit uncomfortably with policymakers.

Given the poor state of labour market data generally, anecdotes should be carefully looked out for that jobs are becoming more problematic.

Policy easing is being baked in

The CCP has been pretty adamant so far that it is unwilling to preside over a major acceleration in credit growth as in years gone by. While some modest rise in credit growth, higher loan targets and more infrastructure spending by local governments should be expected, the authorities will most likely remain restrained in using credit if they can. The GWR, though, does promise to cut financing costs and lending rates, and so it is expected that further small reductions in both interest rates and banks' reserve requirements will occur.[14]

Similarly, further measures to try and soften the downturn in the property market are expected. Many urban authorities have already eased property purchase and financing restrictions, while property developers have been allowed leeway in meeting previously tight balance sheet targets. Attention should also be paid to the role that SOEs are now playing in the housing market – a huge change to experience since privatisation started nearly 30 years ago.

[11] Scott Rozelle and Matthew Boswell, 'Complicating China's Rise: Rural Underemployment', *The Washington Quarterly*, 44 (2021).
[12] Wu Peiyue, 'Tech Workers Are Resigned to Layoffs', *Sixth Tone*, 18/03/2022, https://bit.ly/37muhpf (checked: 06/04/2022).
[13] Masha Borak, 'China's Gig Workers Are Challenging Their Algorithmic Bosses', *Wired*, 14/03/2022, https://bit.ly/3Khs5xK (checked: 06/04/2022).
[14] 'China Cabinet Vows Stronger Monetary Policy Support for Economy', *Bloomberg*, 21/03/2022, https://bloom.bg/3r46txr (checked: 06/04/2022).

Budgetary policy will be the main focus for easing. The budget deficit is predicted to drop from just over 3% in 2021 to about 2.8% of GDP in 2022,[15] but as in other countries, these headline numbers can be, and are, highly deceptive.

- There is going to be a lot more government spending, roughly ¥2 trillion (£240 billion), for example on defence and pubic security while other departmental spending budgets are being cut back;
- Government revenues are predicted to fall by ¥2.5 trillion (£300 billion), thanks mostly to tax and fee reductions and ¥1.5 trillion (£180 billion) of VAT tax refunds, with micro and small and medium size enterprises being the priority;
- Hard pressed local governments will receive an 18% rise in transfers;
- A lot of additional spending is also forecast to be financed by drawing on savings of state financial institutions and state monopolies which have been left untouched for the last two years, as well as by transfers from 'other government accounts or reserve funds';
- These transfers from other funds are likely to be around 2.2% of GDP but while they are treated as revenues, they are in fact liabilities, and so the narrow budget deficit, measured properly, is likely to be closer to 4.75% of GDP, not 2.8%. That is a rise of about 1% of GDP compared to 2021;
- The more broadly defined general government budget deficit that allows for off-balance sheet transactions, subsidies, infrastructure borrowing, social welfare budgets and so on is of a different order of magnitude, roughly 12% of GDP in 2022, but also about 1-1.5% of GDP larger than in 2021.[16]

Also rans and no-hopers

It has been evident for a while that the CCP is anxious about the slump in **fertility** in the PRC and the subsequent demographic consequences in the medium- to longer-term. To this end, the CCP now has a three child (at least) policy. Whether such a policy will work in inducing couples to procreate more is a moot point. In any event, demographers have known that the minimum the state can do to help the process along is to provide cheap and widely accessible childcare.

[15] 'Report on the Execution of the Central and Local Budgets for 2021 and on the Draft Central and Local Budgets for 2022', Ministry of Finance of the PRC, 05/03/2022, https://on.china.cn/35GM0ar (checked: 04/04/2022).
[16] 'China Cabinet Vows Stronger Monetary Policy Support for Economy', *Bloomberg*, 21/03/2022, https://bloom.bg/3r46txr (checked: 06/04/2022).

The 'Two Sessions' reports provided some encouragement here by promising income tax breaks for **child care** expenses for very young children, and providing for the eventual provision of better childcare services. Such policies would join others that the CCP deems important in bolstering the fertility rates, such as those already taken to outlaw expensive private tuition, and control housing and healthcare costs.

It is not known if these policies will be very effective. The only evidence is that top quality affordable childcare is associated with women who tend to have more children at the margin, and one would have to take account of all the measures the CCP is proposing.

The 14th Five Year Plan pledged to gradually raise the **retirement age** from 60 for men, and 55 or 60 for women,[17] but the 'Two Sessions' had nothing to say about plans or intentions.

The laser focus on 'common prosperity' in 2021 included a widespread expectation that at long last **property taxation** nationwide would arrive in the PRC. Before the end of the year, this proposal had been reduced to an acknowledgement that pilot studies would be undertaken in 12 cities, and a decision taken in 2025. Now it seems the pilot studies have been abandoned too.[18] The 'Two Sessions' were not forthcoming at all about the crunch that has descended on the property market or the measures needed to both stabilise it and compensate for it.

'Common prosperity', as previously mentioned, wasn't featured very much as such in the Two Sessions, but as Charles Parton has pointed out, some of the things that are associated with 'common prosperity' such as education, public health, and rural revitalisation, ostensibly remain priorities for the CCP.

There are other things, however, that the CCP does not even want to discuss or sees quite differently, and unsurprisingly, there is no trace of this discussion in the 'Two Sessions' reports.

A remarkable feature of the 'common prosperity' campaign is the strategy for the state to exercise more control over private firms, and to stipulate a more orderly 'expansion of capital'. This represents a significant sharpening of policies, following a few years in which many private firms and entrepreneurs have been subject to political hostility, interference and intrusive regulations. It is already the case that firms in which there are three or more CCP members must have CCP committees close to or in operational management. These are being encouraged to become more involved in staffing, recruitment, supervision

[17] '中华人民共和国国民经济和社会发展第十四个五年规划和2035年远景目标纲要' ['The 14th Five-Year Plan for National Economic and Social Development of the PRC'], *Xinhua*, 13/03/2021, https://bit.ly/3uXNtl3 (checked: 06/04/2022).
[18] 'Conditions not right for China to expand property tax trial this year', *Reuters*, 16/03/2022, https://reut.rs/3x2G1YI (checked: 06/04/2022).

and compliance. In a Central Committee promulgation, issued in 2020, called 'Opinion on Strengthening the United Front Work of the Private Economy in the New Era',[19] a much more politicised business environment for entrepreneurs and private firms was set out.

Since then, many private firms have been the target of a blizzard of regulations and investigations, involving for example antitrust, data privacy, and security. Technology, data, and finance platforms have been especially targeted, but the education, gig economy, healthcare, and housing sectors have also been in the cross-hairs of regulators and policymakers. Leading firms such as Alibaba and Tencent are among many now expected to give something back to society by making 'donations' to CCP programmes in what is a form of coercive corporate philanthropy.[20]

After the 'Two Sessions', as the Chinese stock market rocked to the impact of investor fears related to the Chinese economy and Chinese political support for Russia's war, Liu He, Vice Premier, had to offer words of comfort and assure investors that the regulatory environment would improve, and that the CCP would be more sensitive to investor concerns.[21]

This remains to be seen. 'Common prosperity' is, after all, a political campaign and totem for Xi, not an economic idea or new development model, and no one seriously thinks politics are going to play second fiddle to private investors or markets. At a time when Covid-19 border controls and perceived complicity in Russia's renewed aggression are already threatening to exacerbate the PRC's already troubled economy, the 'common prosperity' campaign is at risk of being undermined at home and overtaken by events abroad.

Managing instability is the task for 2022

Stability was supposed to be the CCP's top priority in the run-up to the 20th Party Congress later this year, but instead, managing instability seems to be the order of the day. Some of the disturbances going on in the economy and in the labour market have been present for a while. It was plain, therefore, to see that even though the CCP has a tolerance for slower growth as such, and a visceral dislike of financial excesses and vulnerabilities, it was content to 'make do' with

[19] Scott Livingston, 'The Chinese Communist Party Targets the Private Sector', Centre for Strategic and International Studies, 08/11/2020, https://bit.ly/3Jcadmv (checked: 06/04/2022).
[20] Jane Zhang, 'Chinese tech giants led by Alibaba and Tencent donate millions towards flood relief efforts in Shanxi', *South China Morning Post*, 11/11/2021, https://bit.ly/3r0OKGP (checked: 06/04/2022).
[21] 'China Likely to Follow Up Easing Pledge With Concrete Steps', *Bloomberg*, 17/03/2022, https://bloom.bg/3DFypwu (checked: 06/04/2022).

a minimum of fuss in terms of new stimulus – so long as there were no new shocks or surprises.

However, the best laid plans, as they say, often go astray, and whether or not the original plan would have worked is now a moot point. New Covid-19 cases have continued to rise and with the announcement of the biggest ever city lockdown in Shanghai towards the end of March this year, the CCP is likely to be even more anxious about prevalence between now and the Congress. The greater the commitment to zero-Covid-19, the bigger the economic price to pay.

Some of the CCP's most sensitive concerns, including energy and food security, have moved centre-stage in the wake of the invasion of Ukraine. Higher costs and prices will sap growth and employment, regardless. The emergence of large capital outflows in the wake of the renewed Russian invasion of Ukraine also threaten to undermine the PRC's economic stability. Beyond these direct effects, the PRC faces the risk of secondary sanctions if it comes overtly to the aid of Russia, but also a growing risk of supply chain disruption as both it and its Euro-Atlantic trading partners push one another apart.

As far as the immediate future is concerned, stabilising the property market will also continue as a major challenge. In the second half of 2021, the PRC recorded its largest ever decline in housing starts, and while the outlook for the property sector is bleak over the coming decade, the current year calls for political measures to reverse or at least arrest the decline.

Accordingly, the CCP is trying to get SOEs and banks to act as a backstop for developer sales of real estate assets, monetary policy is being eased, credit growth has perked up in the first two months of the year and the Budget report shows where and how fiscal easing is scheduled.

These things may do the trick, at least as far as the 20th Party Congress is concerned. Ultimately though, the PRC needs something very different: an institutional reform programme to deliver a productivity boost and distributional change to compensate for 'common prosperity' shortcomings and to offset the consequences of the 'government, the military, society and schools, north, south, east and west – the party leads them all.'[22]

[22] Nis Grünberg and Katja Drinhausen, 'The Party leads on everything: China's changing governance in Xi Jinping's new era', MERICS, 24/09/2019, https://bit.ly/3j84jZ3 (checked: 06/04/2022).

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