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Xi Jinping sticks to his guns: The 2024 Third Plenum

By George Magnus

At the recently concluded Third Plenum meeting of the 20th Central Committee – a quinquennial event often, though not always, associated with economic strategy and reform – the Chinese Communist Party (CCP) laid to rest expectations that new policies might be adopted to address an array of systemic economic problems.

Such expectations were rather fanciful, for, contrary to the popular narrative, there has really only been one truly transformational Third Plenum, in 1978 at which Reform and Opening Up featured as the main and subsequently enduring campaign. For some,the Socialist Market Economy campaign that featured at the 1993 Third Plenum was perhaps also in this league. However, by the 2000s, the People's Republic of China (PRC)'s economy was becoming increasingly unbalanced, as indeed noted by its leaders at the time who opined that growth had become 'unstable, unbalanced, uncoordinated, and unsustainable.'[1]

For Xi Jinping, General Secretary of the CCP, the main focus upon coming to power in 2012 was the Party, itself, its governance structure, and rampant

[1] 'IMF Survey: China's Difficult Rebalancing Act', International Monetary Fund, 07/09/2007, https://www.imf.org/ (checked: 23/07/2024).

corruption and indiscipline, which he set out to address.[2] While he signed off on a large list of economic reforms at the Third Plenum in 2013, most were either diluted or not implemented at all – because Xi's main purpose was to use the economy to advance the centralisation of political control, as a means to then realise important economic and political objectives.

As recently as a week before the July 2024 meeting, state media noted that:

> Reform is not about changing direction, and transformation is not about changing colour. On fundamental issues such as the path, theory, and system, we stand firm, have clear ideas, do not speak ambiguously, and do not engage in activities that are sneaky or concealed. We are unwavering in advancing comprehensively deepening reform along the path of socialism with Chinese characteristics.[3]

This was indeed the gist of the immediate communiqué; the lengthy 'Decision' document that set out the Plenum's discussion in great detail, and the Explanation of the Resolution document by Xi himself.

Instead of any acknowledgement by the CCP for mistakes or failures, which might otherwise have laid out a platform for remedial measures, the 2024 Plenum can be seen as an endorsement of Xi and the 'comprehensively deepening reform' over which he has held sway for over a decade. The Plenum mentions measures to boost demand and consumption, which are key weaknesses, but there was no recognition about the urgency or scale of addressing the flagging consumption sector which accounts for a lowly 37% of Gross Domestic Product (GDP), and is the one sector that could be the basis of a new development model.

The CCP continues to note the importance of addressing economic problems, but its focus on a broad spectrum of national security issues is as, if not more, significant. Indeed, there was a particularly noteworthy emphasis on international relations issues at the meeting under the guise of 'fierce international competition', and 'a grave and complex international environment', confirming, especially to international firms, the fusion, as the CCP sees it, of economics, governance, and geopolitics.

On the economy, the CCP has set three goals in building Chinese style modernisation. First, in deference to the 'Common Prosperity' part of Xi Jinping Thought, it wants to improve people's livelihoods via changes to income

[2] '习近平发表文章:扎实做好保持党的纯洁性各项工作' [Xi Jinping publishes an article: Thoroughly implement measures to maintain Party purity], 中央政府门户网站 [Central Government Gateway Website, People's Republic of China], 16/03/2012, https://www.gov.cn/ (checked: 23/07/2024).
[3] 'New ideas lead the reform and opening up in the new era: Advancing comprehensive and in-depth reform along the right path', *Xinhua News*, 09/07/2024, http://www.news.cn/ (checked: 23/07/2024).

distribution, employment and social policies, perhaps including policies affecting the tax system, hukou residency permits, and pensions.

Second, it vows to adhere to socialism with Chinese characteristics, which acknowledges that market forces, outcomes and private firms have a role to play – it refers to both a decisive role for markets (as in the 2013 Plenum), and to a less ambitious 'better play for the market' – but within the context of 'unswervingly developing the public economy', a total commitment to Marxism, and the full authority of the CCP and CCP goals. Measures to strengthen SOEs, party governance, and state capital deployment, and improve efficiencies by unifying the internal market in the PRC are in prospect. Whether the party's statements about treating the state and private sectors equally are more than rhetoric, is a moot point. However, they are likely not. The Plenum also refers specifically to the parlous state of local government finances and implicitly the dysfunctional financial relationship between Beijing and local governments, and so some changes here are necessary, including on local revenue raising capacity.

Third, and most important, the lodestone of the overarching goal of Chinese style modernisation remains 'high quality development', with its intense focus on industrial policy and innovation, featuring advances in science, technology and education. Xi has referred to this for several months in a Marxist framing, using the expression 'new productive forces' (新质生产力).

High quality development, or new productive forces, are about the PRC's exploitation of science and technology to become a great power, and a 'high level socialist market economy' by 2035, en route to becoming a dominant global power by 2049, the centenary of the founding of the PRC. The state's role in this is pivotal, but private sector efforts can of course be co-opted provided that entrepreneurs stick to the party's rules and serve its goals.

The key question, though, is if the CCP is not going to embrace market-based economic reforms, prioritise the private over the public sector, or engage with more open and neutral institutions, including the rule of law, how is the Party going to realise its grand ambition? And is it being realistic?

New productive forces

Ever since Xi first referred to new productive forces during a fact-finding trip to Heilongjiang province in China's old industrial heartland in September 2023,[4] the phrase has been emphasised regularly. It featured at the annual Central

[4] 'Xi urges Heilongjiang to firmly grasp strategic position in China's overall development, strive to open new ground for high-quality development', *Xinhua*, 10/09/2023, https://english.news.cn/ (checked: 23/07/2024).

Economic Work Conference in December 2023, and Xi told the Political Bureau of the Central Committee in February that 'developing new productive forces is an intrinsic requirement and an important focus of promoting high-quality development', and that innovation would play a leading role.[5] It was highlighted again in the Government Work Report to the National People's Congress in March 2024, in which Li Qiang, Premier of the PRC, emphasised the top priorities as modernising the industrial system and developing new productive forces more quickly, and invigorating the PRC through science and technology.[6]

In a sense, new productive forces is a relabelling of industrial policy, but it has historical and political relevance in modern China.

From an industrial policy standpoint, new productive forces is the most recent iteration in a series of industrial policy campaigns that date back to the 2000s, according to which CCP leadership wants advances in science and technology to spawn transformational change in society, as other so-called general purpose technologies, such as steam and electricity or the internet have in the past. These campaigns have included Indigenous Innovation (2006), Strategic Emerging Industries (2010), Made in China 2025, Internet Plan, Industrial Guidance Funds (2015), Innovation Development Strategy (2016), AI, Smart Solar and Military-Civic Fusion (2017), New Infrastructure and Dual Circulation Strategy (2020), Digital China (2023), and most recently, the focus on innovation and self-reliance as keys to national security and drivers of new growth.

It is hard to be precise about how significant new productive forces are in the economy, but 'Strategic Emerging Industries' is a plausible starting point. Originally spanning 20 or so industries, they have been refashioned into five key areas, and four new priorities. These comprise IT hardware, industrial machinery, biotechnology and pharmaceuticals, clean energy and electric vehicles, and digital media in the former group, and space, networks, life sciences and nuclear in the latter.[7]

These industries, according to official data, accounted for 13.4% of GDP in 2022, compared with 7.6% in 2014[8]. In United States (US) dollar terms, that translates into a roughly US$2 trillion contribution to GDP, and a growth rate over the period 2014-2022 of about 14% per year. The government plans to expand the share to 17% by 2025. *The Economist* recently estimated that annual

[5] 'Xi stresses development of new productive forces, high-quality development', *Xinhua*, 02/02/2024, http://en.cppcc.gov.cn/ (checked: 23/07/2024).
[6] George Magnus, 'China's National People's Congress and the economy: Short change', Council on Geostrategy, 11/03/2024, https://www.geostrategy.org.uk/ (checked: 23/07/2024).
[7] 'China unveils "strategic emerging industries" plan in fresh push to get away from US technologies', *South China Morning Post*, 24/09/2020, https://www.scmp.com/ (checked: 23/07/2024).
[8] 'New productive forces reshape China's economic landscape', *Xinhua*, 06/02/2024, https://english.news.cn/ (checked: 23/07/2024).

investment in 'new productive forces' has reached about US$1.6 trillion, equivalent to about a fifth of all investment, with a growth rate not dissimilar to that for Strategic Emerging Industries, as defined. [9]

New productive forces also do not come cheap. Barry Naughton, the well known sage of the PRC's economy and industrial policy, has noted aptly that Beijing is engaged in 'the greatest single commitment of government resources to an industrial policy objective in history.'[10] It is hard to evaluate exactly how much this commitment costs, because of the lack of transparency regarding local governments, non-listed corporate enterprises, and a plethora of preferential treatment and financing schemes. According to one estimate, direct industrial policy subsidies; including tax credits and incentives, other below-market borrowing, R&D funding, subsidised credit, the spending by about 1500-2000 so called 'government guidance funds', and discounted land sales and tax incentives collectively amounted to about 1.7% of GDP in 2019.[11] By 2023, this number must have been appreciably higher – and in relation to a GDP of about US$20 trillion. For reference, this compares to 0.4% of GDP in the US, and a range of 0.3-0.7% in other nations considered, including Brazil, France, Germany, Japan, South Korea and Taiwan.

It is important, though, to also understand what it means to Leninist China to establish dominance in these new technologically complex industries. Xi has a strong ideological sense of the development of and turbulence in human history, and refers often to 'great changes unseen in a century' which are playing out across the world. In standard Marxist parlance, he views the challenges and transformative contradictions posed by today's revolutions in technology, science and artificial intelligence as highly disruptive to the existing economic order at home and in the wider world, leading to structural changes in 'production relations' in which the old order is upended. For Xi, the CCP has to be in the vanguard of change to exploit the contradictions in the economy and society triggered by disruptive technologies and science.[12]

The CCP has a particular sensitivity in this regard, believing that the PRC's 'century of humiliation', unequal treaties, and imperial carve up in the 19th century were attributable to its inability or failure to embrace and exploit the

[9] 'Xi Jinping's misguided plan to escape economic stagnation', *The Economist*, 04/04/2024, https://www.economist.com/ (checked: 23/07/2024).
[10] Barry Naughton, *The Rise of China's Industrial Policy 1978-2020*, Universidad Nacional Autónoma de México, 2021, https://dusselpeters.com/ (checked: 23/07/2024).
[11] Gerard DiPippo, Ilaria Mazzocco and Scott Kennedy,'Red Ink: Estimating Chinese Industrial Policy Spending in Comparative Perspective', Centre for Strategic and International Studies, 05/2022, https://csis-website-prod.s3.amazonaws.com/ (checked: 23/07/2024).
[12] Yin Hejun, 'Let technological innovation inject powerful impetus into the development of new quality productivity', *Qiushi*, 01/04/2024, http://www.qstheory.cn/ (checked: 23/07/2024).

industrial revolution.[13] Xi insists that by doing so in the modern era, the PRC will be able to leapfrog developed market economies, in particular the US, reframe the global governance system and international order, and thereby, help to terminate America's era of global leadership.

New productive forces, then, are a rather old political concept but they embody and are applied to the latest developments and achievements in the contemporary PRC, and serve as a framing mechanism for Chinese industrial and social policies, and for the CCP's governance model. The stakes are high.

Contradictions and caveats

For, while the PRC's 'new development concept', as Xi puts it, is benefitting from the considerable attention and funding from the state and local governments, it is not a shoo-in to succeed across the board, and certainly not when judged, sector by sector, against its peers. The PRC is a world leader in production and manufacturing, but while it has ambition, its track record, relatively speaking, is patchy or weak in, for example, design, standards, branding, profitability and commercialisation.[14] Because of its rigid political structure, controlling governance, and exclusive institutions, there remain major doubts about its capacity to propagate economy-wide innovation and integrate disruptive change, especially in a new lower-growth environment.

This not to deny the past or likely future successes which Chinese manufacturing has already made in specific, rather than economy-wide areas, for example in e-commerce, mobile payments, electric vehicles, solar and wind technologies and so on. The problem, however, is that while there is little doubt about the significance of the PRC's footprints in global manufacturing and its undeniable successes in several spheres of industry and technology, there is also no doubt that it faces challenging, even alarming, systemic macroeconomic problems. This spans both well known domestic issues, and the rising threat of friction deriving from the PRC's mercantilist disposition towards over-production, over-capacity, and outsized trade surpluses. The image of the PRC as a large, important country with both a world class manufacturing sector, especially in electric vehicles, and climate change mitigation equipment and

[13] See, for example: Alison A. Kaufman, 'The "Century of Humiliation" and 'China's National Narratives, Testimony to US-China Economic and Security Review Commission', 10/03/2011, https://www.uscc.gov/ (checked: 23/07/2024).
[14] Joe Ngai, '5 critical shifts Chinese firms need to make to be successful', *South China Morning Post*, 12/06/2024, https://www.scmp.com/ (checked: 23/07/2024).

parts – and deep-seated systemic imbalances is indeed a curious one to integrate, but as we shall see below, not unique.

It is also curious that the CCP persistently conflates industrial policy with innovation, but they are not the same thing and have quite different implications. Industrial policy is about a vertically integrated set of policies according to which the government wants to create national champions. It targets and develops output, market share, and products in specific firms and industries, often with a view to maximising exports and trade.

Innovation, on the other hand, is a more horizontal concept, according to which the government tries to create stronger and more inclusive institutions by focusing on areas that might be beneficial to industries and sectors across the board, such as competition and regulatory policies, education and skill formation, and infrastructure, tax and labour policies.

Beijing's focus has mostly been on the former, and the new productive forces campaign certainly looks to Chinese firms to dominate in key industries and sectors with targeted assistance in various forms.

Innovation, though – a constant refrain among Chinese policymakers – isn't quite as simple to evaluate. According to the World Intellectual Property Organisation's Global Innovation Index, the PRC ranks prominently in some areas, but much less so in others. The index is based on 80 measurements, and ranked the PRC in 12th position overall among 132 nations in 2023, a position which it has held with small variations since entering the top echelon in 2014.[15]

The PRC was ranked in eighth position on so-called innovation and creativity *outputs*, but 25th in terms of innovation *inputs*. The former include measures of knowledge, patents and citable documents, labour productivity, software spending, intellectual property, high tech exports, and trademarks. The latter comprise things like the quality of regulatory, competition, legal and business institutions, educational attainment, research and development, communications and other types of infrastructure, and measures of business and market sophistication.

In other words, while the PRC's manufacturing capacity and ability to absorb and exploit technology is world class at the current time, the things that ultimately determine those outcomes, especially the institutional factors that help to nurture creativity and initiative, are not really in the same league.

Considering patent registration too, there are some curiosities behind the headlines. Globally, the PRC now accounts for almost half of global patent registrations, but most Chinese registered patents are of the lower value utility type, compared to the more science and innovation-oriented design patent

[15] Global Innovation Index 2023, World Intellectual Property Organisation, 2023, https://www.wipo.int/ (checked: 23/07/2024).

variety, in which the US, Germany and Japan, for example, excel. Moreover, less than 10% of Chinese patents are filed and granted abroad, far lower than Beijing's key competitors. Further, in a study published earlier this year, researchers looked at 4.6 million patents filed from 1990 through 2014 in 333 mainland Chinese cities.[16] They found evidence to support the view of a high level of gaming of top-down patent targets in the PRC, so that high registrations were often attributable to wasteful subsidies and public resources, and the proliferation of duplicative and low value patents.

A further problem for the PRC's industrial policy or innovation strategy is the risk, now increasingly likely, that doubling down on manufacturing is tantamount to externalising its domestic economic imbalances and shortcomings. In other words, the consequences of Beijing's industrial and economic policies for other countries are felt via higher imports from the PRC, lower prices, higher trade imbalances and the possibility of threats to jobs, resilience, and national security. During visits to Beijing in April, both Janet Yellen and Anthony Blinken, the Treasury Secretary and Secretary of State of the US, respectfully, referred to the PRC's unfair trade practices and to the global economic consequences of the overcapacity resulting from industrial policy initiatives. Consider that, as of now in 2024, the PRC manufactures 80% of the world's solar panels, and most of the capital equipment needed to manufacture them. It out-produces everyone in wind turbines and components.[17] In addition, there are long standing concerns about over-production in steel, shipbuilding, industrial materials such as glass and cement, railway and highway infrastructure, internal combustion engine vehicles, and now – though perhaps still contentiously – in electric vehicles and batteries.

The US maintains high tariffs on Chinese cars and the Biden administration has largely favoured non-tariff measures in the Inflation Reduction and Chips and Science Acts, passed in 2022, to build supply chain resilience in green technologies and semiconductors, and serve national security goals –alongside export controls and regulations affecting business with Beijing. In May 2024, the Biden administration imposed large tariff increases on a range of Chinese exports including steel, aluminium, semiconductors, solar cells, ship-to-shore cranes, medical products, and especially Chinese-made electric vehicles to which 100% tariff rates will apply. Donald Trump and political associates have already warned that, if elected, they would impose much higher tariffs both on the PRC and other countries.

[16] Yuen Yuen Ang, Nan Jia and Kenneth G. Huang, 'China's Low-Productivity Innovation Drive: Evidence From Patents', *Comparative Political Studies*, 03/11/2023, https://journals.sagepub.com/ (checked: 23/07/2024).
[17] Brad Setser, 'China's Record Manufacturing Surplus', Council For Foreign Relations, 10/03/2024, https://www.cfr.org/ (checked: 23/07/2024).

European and other countries including Japan, India, Brazil, Turkey and Indonesia have also launched investigations into and or proposed to raise tariffs on Chinese exports spanning a range of different types of products. The European Commission decided in July to implement higher tariffs aimed at companies rather than the entire electric car sector.[18] Indeed, it is impossible to envisage how the PRC, where manufacturing is already about 29% of GDP, and a third of global manufacturing, could further subsidise and boost manufacturing as part of its industrial policy strategies without incurring bigger imbalances and debt at home, and imposing larger trade deficits on the rest of the world.[19]

The tensions then between Chinese industrial policy ambition and rest-of-world consequences are only likely to increase. They will most probably underscore the CCP's rush to access technologies and knowledge needed to become self-reliant, while other nations continue to rely on the PRC. Yet, they will also reinforce the urgency and scope of foreign governments, especially the US and close allies, to ensure that these objectives are stymied.

Industrial policy is no panacea

Whether or not high quality development and new productive forces will help or hinder the PRC's economic development, or simply sit alongside unaddressed macroeconomic weaknesses is a moot point. While Xi has clearly asserted his belief in successful outcomes, it is only fair to point out that the PRC features many factors that are more likely to undermine or complicate industrial policy than advance it, including an unswerving belief in the power and effectiveness of the state sector and government direction; weak competition, legal and regulatory institutions; rent-seeking and corruption; and a poor macroeconomic backdrop.

The CCP's new productive forces strategy is also a two-sided coin. On the one side, the PRC is acknowledged as having accomplished much and showing promise in science and technology. On the other, even commercial capacity and innovative flair are not a foolproof guide to the future.

Referring to the economic strategy of the US' principal adversary, the words of a leading American academic ring out. He said:

[18] 'EU confirms steep tariffs on Chinese electric vehicles, effective immediately', *Euronews*, 04/07/2024, https://www.euronews.com/ (checked: 23/07/2024).
[19] Michael Pettis, 'The global constraints to Chinese growth', *Financial Times*, 07/11/2023, https://www.ft.com/ (checked: 23/07/2024).

> It would be foolish to doubt that this strategy will result in spectacular advances and growing supremacy in a variety of fields such as industrial ceramics, lasers, semiconductors, biotechnology, solar energy, robotics, superconductors and possibly in space exploration. These advances, in turn, will be largely used in consumer products and will lead to increasing exports, rising techno-nationalism, and deepening fears among Americans that we can no longer compete.[20]

Yet, this was George R. Packard, a former Dean of the School for Advanced International Studies at Johns Hopkins University, writing in *Foreign Affairs* about Japan in 1987. Today, it could have been written about the PRC. The lessons from Japan are salutary. Within a few years, Japan's leading technology, auto, finance and trading household names such as Sony, Hitachi, Toyota, Honda, Matsushita and Sumitomo, would succumb to far bigger macroeconomic turbulence and be forced to adapt to a major economic shock, lasting almost a quarter of a century.

The lesson is that two things can be simultaneously true. You can have world-class companies such as Alibaba, Tencent, Huawei, BYD, CATL, and achieve highly in science and technology. You can also have an economy in which deep, systemic economic imbalances, asset bubbles, and political contradictions and institutional rigidities run deep. Having great firms and strong top-down industrial policy do not protect an economy against bad macroeconomic policies and outcomes. Technological islands of excellence in a sea of economic troubles comprise a contradiction the CCP might be pushed to resolve.

The Third Plenum did not feature an acknowledgement by the CCP of culpability for these troubles, or by doing so, offer up a platform for remedial policies. Instead, by endorsing Xi, and sticking to his guns, the Party is likely to exacerbate this contradiction.

[20] George R. Packard, 'The Coming US-Japan Crisis', *Foreign Affairs*, Winter 1987-1988, https://www.foreignaffairs.com/ (checked: 23/07/2024).

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