China and the Crisis: Global Power, Domestic Caution and Local Initiative

Shaun Breslin

Abstract

Even though the global crisis had a quick and dramatic impact on Chinese exports, the Chinese government responded with a range of policy responses that have helped maintain high rates of growth. This success has helped propel China to the centre of global politics, accelerating what many perceive to be a power shift from the West to China. But these gains were achieved by reversing policy in previous years designed to make a fundamental shift in China's mode of development, and have highlighted the problems associated with making such a transition. At the moment that many are looking at the Chinese "model" as a potential alternative to the Washington Consensus, one of the consequences of the crisis is to further question the long term efficacy of this "model" in China itself.

Shaun Breslin is Professor of Politics and International Studies and Director of the Centre for the Study of Globalisation and Regionalisation at the University of Warwick. He is also an Associate Fellow of the Chatham House East Asia Programme at the Royal Institute of International Affairs. Shaun.Breslin@Warwick.ac.uk

Introduction

China by most accounts had a "good crisis". Despite an early collapse in exports from November 2008, the government responded with a raft of measures that resulted in an 8.6 per cent growth rate in 2009 while much of the rest of the world was in recession. In the process, China overtook Germany to become the world's biggest exporter, and in 2010 passed Japan to become the world's second biggest economy. As the world's leaders sought for solutions to the global crisis, what everybody really already knew – that China was now a central actor in global economic governance – was confirmed by the attention paid to Hu Jintao at the G20 leaders' summit in London. With Western governments using tax payers' money to prop up private companies (and even nationalising them) the official People's Daily suggested that the US (and others) looked more socialist than China; indeed, it was no longer a case of asking if socialism could save China, but instead asking if China could save global capitalism (Wang 2009).

But while some looked to Chinese overseas investment and increased consumer demand as a possible way out of the crisis, others viewed this rise to prominence with concern as Chinese voices appeared to become more assertive. Chinese fingers were pointed at those in the West who were to blame for the crisis – and the fact that the "West" had been so quick to blame Asia when it had a crisis in 1997 was not forgotten. Chinese preferences for a reformed global order were also increasingly forcefully articulated with the Governor of the People's Bank of China calling for a new "super-sovereign reserve currency managed by a global institution" to replace the dollar (chao zhuquan chubei houbi 超主权储备货币) (Zhou 2009). The internet was rife with warnings that a newly confident China might even dump its dollar holdings, or threaten to dump them to hold the US to ransom (see http://tinyurl.com/chinadollardump). At the very least, China looked as if it might provide an alternative model for other developing states that following the western liberal road.

It will take more years for the real consequences of the crisis to become clear – for example, to know whether the Chinese response has generated bubbles that will burst or generated a "debt crisis" (or maybe even both). But enough time has passed to make some analysis of what the response to the crisis tells us about the nature of China's political economy, and how China's leaders might utilise their "new" power in the global system. Domestically, the response to the crisis highlights the state's ability to mobilise the economy behind a national effort when it needs to. But at the same time, the commitment to do whatever it took to ensure eight per cent growth suggests a certain fragility and a belief that the social order might become easily become disordered. Ironically, while the crisis reinforced for some the need to change the pattern of global engagement and change the mode of growth promotion (Yao 2010), short term considerations instead resulted in much of what the central government had been trying to do over the previous four or five years being put on hold or reversed.

China's response to the global crisis did not emerge ex nihilo in late 2008; it was a reflection of long held concerns about the sustainability of existing modes of global engagement and growth promotion. When viewed in the context of three decades of post-Mao economic restructuring, it seems that it is relatively easy to spur rapid growth in China, but much harder to control and slow it; it is an economy that has growth (rather than development) impulses written into its DNA. Moreover, while the Chinese state remains a crucial actor, interests and dynamics have been created that restrict the ***central*** state's freedom of action and their ability to shape China's economic future as they would like.

These domestic considerations have had a knock on effect on Chinese conceptions of China's place in the world. Whilst there is clearly pleasure in China that it is considered to be a major global actor, and that institutions like the IMF are restructuring their power structures accordingly, this does not equate to a desire to take on a concomitant global leadership role. Partly as a consequences of perceived unrealistic expectations of how China would act at the Copenhagen environment summit in December 2009, there seems to have been an attempt to reduce expectations about what China can and will do. The message is that China is still essentially a poor country, with myriad domestic problems to resolve and dealing with these domestic vulnerabilities will be the main challenge for years to come. While this domestic focus is argued as having clear benefits for the rest of the world as it recovers from crisis, if this means putting domestic Chinese interests above those of external actors – for example, over exchange rate policy – then so be it.

Rethinking China's Mode(l) of Development

Chinese growth and dependence on the global economy

It might seem odd to suggest that there is any problem with a model that has delivered high growth rates over a number of years, and has seen China emerge from both regional and global economic crises stronger than many. But almost since the beginning of China's re-engagement with the global economy, there have been debates in China over its long term viability focussing on four main concerns. First, the model seemed to be unbalanced, with exports and investment playing too great a role compared to domestic consumption. Second, and very much related, the extent to which this growth model was dependent on overseas sources of finance and overseas markets for exports produced in China with this investment was thought to have created a sort of double dependence on the global economy. Third, the pattern of global engagement had contributed to an uneven spatial distribution of growth and inequality, which in turn was deemed to present a challenge to social stability. Finally, there was a question over the “quality” and of growth – particularly that growth produced by the exports of Foreign Invested Enterprises (FIEs).

With foreign investors producing for export in China typically importing the vast majority of the components from overseas, much of the benefit of export led growth was being located outside China. For example, before the onset of the global crisis in 2007, FIEs produced 57 per cent of all Chinese exports, and imported just over 80 cents of components and other resources for every dollar they exported. Moreover, the higher the level of technological sophistication of the export, the higher the dependence on imported foreign content (Koopman, Wang and Wei 2008). Yu Yongding sees the basic problem in the incentive system for local officials and the equation of “success” with “growth” – an emphasis on qualitative rather than quantitative indicators, with local governments competing to provide incentives to attract investment. The more contracts signed, the more investment secured, the more exports generated the more “successful” the local leadership – irrespective of what this meant in the long term in terms of technology transfer, skills, value added that remained within China, and the tax take from export sectors (Yu 2006). Short term growth was being achieved, but this was not laying the basis for the long term sustainable development of the country.

Is China Export Dependent?

The extent of imported components in foreign invested exports has led to considerable debate over the extent to which Chinese growth really has been/is “dependent” on exports; a debate that was thrown into sharper contrast with the onset of the crisis. Figures for 2007 suggest that domestic consumption accounted for 38.6 per cent of growth, domestic investment just less at 37.7 with net exports making up the remainder. This meant that domestic consumption was about 36 per cent of overall GDP (not to be confused with its share of GDP growth) – a considerable drop from figures of around 60 per cent in the 1980s and 90s – with exports at just under 40 per cent of GDP.

Given the extent of imported components in FIE exports, it has been argued that simply using export to GDP figures doesn't give a real indication of the actual impact on the real Chinese economy (He and Zhang 2010). As perhaps most famously argued by UBS Managing Director, Jonathan Anderson (2007), the key is instead to consider the value added of exports, rather than the gross figure. So if we do a very blunt calculation and strip out the value of imported components in exports, then we can roughly halve the headline figure to get an export value added to GDP figure of around 20 per cent (Akyüz 2010, p.7). Anderson's goes further by stripping out inputs from domestic sectors to reach a figure of less than 10 per cent (2007, 3). Moreover, as China has moved from exporting toys and textiles to IT goods with higher levels of imported components, then reliance on the global economy according to this argument has decreased. The idea that Chinese growth is export led, then, is "the biggest and most pervasive 'China myth' of them all" (Anderson 2007, p.1). From this perspective, the "problem" of what Steinfeld (2004) termed "shallow" integration and the lack of Chinese involvement in supply chains is ironically a strength as it insulates the "domestic" economy from the vagaries of global economic turmoil. If external demand for exports dips, then it would have an impact on exporting industries but not penetrate into the domestic economy in any great way. Thus, according to this argument, China has "been effectively 'decoupled', and …. has little to fear from a global demand slowdown" (Anderson 2007, p.1).

And yet China's leaders appear to have been very fearful of a global turndown in demand. For example, as the rate of the growth of exports slowed in the first third of 1997 in the wake of the Asian financial crisis, the Minister in charge of foreign trade, Wu Yi, appeared on national television warning of the dangers of slowing growth rates for employment and social stability. This was not a case of exports actually declining - exports were still growing at over 11 per cent over the previous years – but simply that they were not growing fast enough as far as the government was concerned (Breslin 1999).

For critics of the decoupling argument, Anderson and others have underestimated the changing nature of Chinese exports and the increasing significance of capital goods and Chinese made components (even if they are components in less technologically sophisticated exports) (Cui and Syed 2007). In addition, despite the delinking of export value added in Anderson's method, others argue that this simply ignores the fact that export growth is in itself a driver of "domestic" sources of growth like investment and consumption (Cui, Shu and Su 2009). Add this all together, and rather than the real importance of exports for growth being less than the percentage to GDP figure, it is possible to get an even higher figure:

> Despite high import content of exports, one-third of growth of income in China in the years before the outbreak of the global crisis is estimated to have been due to exports because of their phenomenal growth of 25 per cent per annum. This figure goes up to 40 per cent if spillovers to domestic consumption (the multiplier) are accounted for and to 50 per cent with knock-on effects on domestic investment. (Akyüz 2010, p.7)

Moreover, given that the vast majority of exporters are located in China's coastal provinces, it is perhaps not surprising that it is in these localities that the "spillover" effects of export growth into the domestic economy are most pronounced (Ljungwall 2006). National figures thus flatten out the significance of export growth for specific parts of the country – particularly as a means of generating and maintaining jobs in China's coastal provinces. Given the leadership's concern with maintaining social stability, the social and political significance of export growth are thus greater than its actual statistical significance.

So while the largely economistic academic picture looks somewhat unclear, the politicised policy debate in China itself seems to be somewhat more straightforward with a consensus emerging that

> Although the economy has maintained double-digit growth for years, fixed-asset investment and exports have dwarfed consumption as the two pillars of expansion. With global recession clearly in view, China must sustain itself by exploiting the domestic market to offset weaker demand abroad (People's Daily 2008)

For Yu Yongding (2009), the real key to understanding the extent of vulnerability in China is not to consider fixed assets investment and export growth as two separate parts of the economy, but instead to think of them as part of a single structural economic problem. Fixed asset investment has resulted in overcapacity that simply cannot be consumed within China. As the Chinese economy has grown, it "has become increasingly difficult for the global market to absorb China's excess capacity" (Yu 2009, p.8). So if investment is increased to compensate for a decline in global demand, this actually exacerbates the structural problem of overcapacity and makes things worse in the long term – hence the need to increase domestic consumption and reduce both export dependence ***and*** investment as sources of growth.

China and Crises Take One: Responding to 1997

The Asian financial crisis of 1997 marked a crucial turning point in Chinese thinking on the Chinese "model" and the nature of economic security (Fewsmith 1999, Zha 1999). Although there seemed to be something of a consensus that the relatively protected nature of the Chinese economy had helped the country survive the crisis relatively unscathed, some Chinese leaders saw stabilising access to key overseas markets through membership of the WTO as the best way forwards. Both the crisis itself and the resulting move towards WTO entry sparked new debates over China's position in the global political economy.

Specialists in culture, literature and language like Wang Hui, Wang Ning, Chen Xiaoming, Zhang Yiwu and others searched for alternatives to the dominant Western discourse(s) of globalisation based on an "indigenisation" of thinking that "envisages a social and cultural horizon beyond the tunnel vision of a Eurocentric concept of modernity" (Zhang 2002). For another set of Chinese thinkers, realist conceptions of IR were found wanting in understanding the impact of globalization, forcing a rethink of the relationship between political and economic dynamics, and the relationship between the domestic and the international (Wang Yizhou 2008). Others simply argued that liberalising reforms have made not only made China very vulnerable to external economic forces and shocks, but also exacerbated vulnerabilities and weakened the state's ability to respond to potential crises. In his work on the evolution of new security issues in Chinese IR thinking, Yeung (2008: 191) found that:-

> Of the myriad threats identified by these experts as potential threats to China's economic security, five core themes stand out: (1) challenges to the competitiveness of Chinese enterprises and economy, (2) issues relating to the security of resources vital to the economy, (3) questions to the health of China's financial infrastructure, (4) security issues relating to its socio-economic development, and (5) economic security issues stemming from its embracing of free trade agreements and an open market economic system.

Scratch the surface of the new security agenda, and older more traditional security concerns about China's place in the world are revealed. It was not just that Chinese growth had become too dependent on the global economy, but that it had come dependent on the US. And the US, as the hegemonic power in a unipolar global order, was prepared to use the global economy as a tool in the pursuit of its national power. Somewhat ironically, then, while much of the world became increasingly concerned about China's strength as a global economic force and China's massive financial power, for some in China at least, the focus was on potential vulnerability and weakness.

The logic of these arguments had an increasing impact on official rhetoric and to an extent polity even before Hu Jintao and Wen Jiabao succeeded Jiang Zemin and Zhu Rongji in 2002 and 2004 respectively. But as noted in the pages of this journal (Breslin 2008), the idea that the existing "model" was reaching the limits of its useful life and needed to be replaced by a new "scientific" development paradigm became increasingly dominant under the fourth generation. If we ignore for the time being "political" issues (the party's relationship with the people/democratisation; minority policy; freedom and rights and so on) the main challenges in developing a new paradigm seem to be:

- how best to ensure state regulation of a hybrid economic system, and state dominance (if not control) of an economy where non-state sectors are the main producers of growth
- how best to ensure national coordination of the national economy when local authorities are important loci of power and economic activity
- how best to support and defend the "national" economy/national producers whilst integrating with the global economy

- how best to meet the myriad and sometimes competing demands of different societal interests in an increasingly diverse and complex society
- how best to conceive of the relationship between encouraging growth, and ensuring that the growth is conducive to developmental objectives

Changing the pattern of growth

In trying to deal with these challenges, from 2004 till quite late in 2008, the main challenge was to slow the economy, not boost it. Or more correctly, it was to slow the growth in fixed assets investment (which had been exceeding GDP growth) and the problem of overcapacity noted above (Yu 2009). One area in which policy really did seem to be having an impact was in China's competitive advantage as a cheap export production platform. In combination, the reduction of the export tax rebates that had done so much to make Chinese exports price competitive, the firm implementation of labour laws, and the appreciation of the RMB by around 20 per cent in the three years from the end of the currency peg in July 2005 began to squeeze profits in low-tech processing export industries. Even in a country like China with relatively strong financial and currency controls it is still not easy to control international financial flows and the inflow of "hot money" into China betting on further appreciation seems to have taken some in China by surprise, having a more detrimental impact on exporters than was originally expected. This impact was exacerbated by what started as a slowdown in demand in the major markets in the West. By the summer of 2008, low value added processing exporters were laying off workers and closing down with reports suggesting even greater problems in the second half of the year.

It is notable that China's top leaders all visited the coastal provinces with the greatest concentration of export industries over the summer - Hu Jintao went to Shandong, while Wen

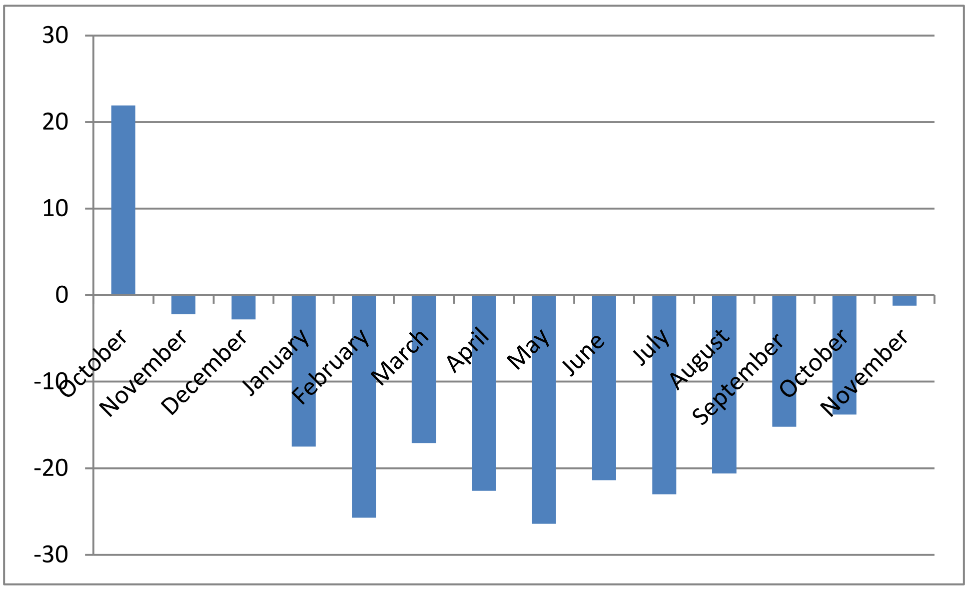
Jiabao and other central leaders visited Guangdong, Zhejiang, Jiangsu and Shanghai. Just over a year after cutting tax rebates and after a series of meetings of top officials in Beijing, the policy was partially reversed and some rebates restored in July 2008. The leadership also cut back on currency appreciation, and adjusted other policies in an attempt to restore some of the support for exporters that had previously been withdrawn (Naughton 2008). Even at this stage, it seemed as if a combination of concern about employment and pressure from financial interests in China's richest provinces was enough to overturn previously agreed policy

China and Crisis Take Two: 2008-

And then exports were really hit. For the first time since 2001, there was a year on year drop (not just a slow down in the rate of growth) of 2.2 per cent in November 2008. While this might not sound too disastrous, to put this in some context, the year on year figure for October was a 21.9 per cent increase – roughly the average monthly increase for the year. Table 1 shows the monthly year on year decrease before rebounding in December 2009 (albeit against a 2008 figure which was itself down against 2007). When totalled up, exports in 2009 as a whole were down 16 per cent on 2008.

Table One

Monthly % changes in exports (year on year), October 2008-Nov 2009



Source: Ministry of Commerce, statistical reports, various issues, available at http://english.mofcom.gov.cn/statistic/statistic.html

The government's response was quick; on 9th November, it announced a RMBB4 trillion stimulus package. On closer inspection, it turned out that some of the fund had previously been pledged as part of the Sichuan earthquake recovery strategy, and that the central government was only committed to funding around a quarter of the total, with the remainder expected to be provided by local governments (Dyer 2008). Subsequent announcements by local governments of how they were going to provide local fiscal stimulus appeared to be more to do with rhetorically reaching targets than providing an accurate guide to economic activity. In combination, the total was around five times more than they were expected to provide to reach RMB4trillion, reaching a hardly believable combined total of RMB18 trillion ! (Yu 2009, p.10). So in many respects, announcements and targets for stimulus packages were more important as a sign of government commitment and a signal of a change in policy than they were a indication of what was happening in the real economy. As Barry Naughton (2009, p.2) put it "the Chinese government had simply announced a very big, vague number"! In Central Document 18, the central government more or less gave the green light to authorities at all levels to do whatever it took to promote growth – perhaps most importantly through the expansion of bank credit (Naughton 2009).

A number of analyses have provided details of the specific policy initiatives (Zhang, Li and Shi 2009, Zheng and Chen 2009, Yu 2009, Naughton 2009, Snyder 2010). Here the intention is to provide a broad overview of the way in which the government responded in five different areas:-

- ***Fiscal Expansion*** – not just the RMB4 trillion but the combined total of local government fiscal stimulus plans …..
- ….. and other measures for the ***Promotion of Domestic Consumption*** – divided into formal support (subsidies to aid rural consumption, tax breaks on some automobile purchases etc) and informal (state entities encouraged to buy – and buy Chinese)
- ***Exchange rate policy*** – a cause of much debate and Sino-Us friction in particular….
- ….. and other measures designed to ***Protect and Support*** domestic interests from international competition. Both European and US surveys have both concluded that there has been an inward turn and it is harder to do business now in competition with domestic companies than before the crisis (Wuttke 2010, Brasdsher 2010).
- ***Monetary policy*** – 2008 witnessed a dramatic shift from interest rate rises to fight inflation to interest rate cuts and, through Central Document 18 and other announcements, the attempts to restrain credit growth over the previous five years were removed as banks were encouraged to lend to keep the economy going.

Centre-Local Relations and the Chinese Financial System

In order to historically contextualise the Chinese response to the crisis, it is important here to briefly focus on the relationship between local and central levels of government as managers/regulators of Chinese economic activity. In the 1980s, the decentralisation of power from central to provincial governments interacted with the emergence of new forms of economic activity, the switch from plan allocation to bank lending as a key source of finance, and the opening of new sources of finance to result in an important tip in the balance of authority from the centre to localities. In many respects, this move, whilst not wholly intentional in the way it occurred, proved highly successful in spurring economic growth – particularly in those provinces that were able to locate themselves (or at least, part of themselves) in global production networks.

But despite its role in promoting growth, the lack of central control was deemed to be obstructing the emergence of a "rational" national economic system. The myriad and at times competing policies of local governments resulted in duplication of production and overcapacity, and made it difficult for the national government to exercise macroeconomic control (particularly when it came to trying to slow economic growth). The central government also felt that it was unable to fully meet its fiscal responsibilities with too much of the nation tax take remaining in the hands of local governments. So from the introduction of new fiscal reforms in 1994, the emphasis has been on redressing this imbalance and creating a new form of central macroeconomic control – a task that was largely achieved by the turn of the millennium.

In response, to losing these fiscal resources, local governments sought to find new sources of income by developing fees as a key source of income, to the extent that fee income exceeded fiscal revenue as a source of collective local government finances by the end of the 1990s (Gao 1999). But even this source of funding was closed by the introduction of fee to tax reforms which, alongside the abolition of the agricultural tax in 2006, were thought to be placing too great a burden on the rural population in particular, and were in part blamed for increasing outbreaks of rural unrest (Kennedy 2007). As a result, it was now local governments that found themselves with insufficient funds to meet their development commitments at a time when they were being pressed by central leaders to expand access to health, education and welfare (Yep 2004, Chou 2006) According to one study, this resulted in local governments turning to their relationship with local enterprises as a means of making up deficits:

> As local governments cannot raise bonds to finance their social and hard infrastructure, they are far more reliant on their local producers than are local governments in OECD countries. Their reliance on value-added tax (VAT) and business tax means they tend to encourage investments that maximize their fiscal incomes regardless of the overall market situation (Roland Berger 2010, p.11)

Over the years, local governments have done this by using their relationship with local branches of banks to support such favoured local producers . By the time that the Asian financial crisis broke out in 1997, the Chinese banking system was, by Western/market conventions, “insolvent” (Harding 1997) with non-performing loans that would never be repaid exceeding the capital of the four main state banks. Through refinancing, debt to equity swaps, the eradication of local branches of the People’s Bank of China, stronger regulation of banking activities and through monetary policy the bad debt problem was gradually eased – albeit it at considerable cost.

Back to the Future?

What this suggests, then, is an ongoing struggle between central and local governments. On one side, a central government trying to prevent financial chaos and the waste of resources through overcapacity and excessive, uncontrollable and ultimately unsustainable growth. On the other, local governments that strive to find ways of making up for the lack of funding that they are getting from central financial transfers to meet their costs and objectives. As already noted, right up to the early autumn of 2008, the central government's objectives had been restraint and control. The stimulus package and Central Directive 18 turned policy on its head. Local governments were being told to take their share in boosting the economy without being given the resources to do so – but with controls on bank lending relaxed. Although local governments were not formally legally allowed to directly borrow form the banks to fund projects, they did so indirectly though various forms of locally owned companies known as development investment platforms (difang fazhan rongzi pingtai 地方发展融资平台 or more formally local development government investment platform companies – difang fazhan zhengfu rongzi pingtai gongsi).

By the end of 2009, new bank loans in China had reached more than double the stimulus package at RMB9.6 trillion with about half funding infrastructure projects via such local investment platforms (Wang 2010). The total debt of these local companies ranging anywhere from official statements of around RMB6 trillion to Victor Shih's guesstimate of RMB11 trillion (Batson 2010). When the highest calculation is added to other debts, then on a national level at worst debt is about a third of GDP. However, this debt is not equally spread across the country, with ten cities and provinces reporting that their local investment companies' debts were over 100 per cent of local GDP, with some reporting a figure as high as 400 per cent (Wang 2010). In the short term at least, local governments gained a degree of local financial freedom, banks ran the risk of increasing the number of bad loans on their books and overcapacity and oversupply was exacerbated. In short, the response to the crisis unleashed (and again, for the short term at least) exactly those problems that policy up to the Autumn of 2008 was trying to resolve.

In many respects, there doesn't seem to be anything special about China here – other countries responded to the crisis in ways that undermined or reversed previous policies and even apparently firmly held (neoliberal) ideological convictions. If there is something special about China, perhaps it lies in the sheer scale and size of the response – itself in part a consequence of the sheer scale and size of China. We might also point to the ability to get banks to lend money – something that proved rather difficult even when governments bailed out banks and/or took them into the public sector, as in the UK.

Land Local Governments and Debt

The relationship between land ownerships, potential asset bubbles and bank debt is also worthy of attention. Hsing (2010, p.5) argues that as land become commodified but not privatised after 1988, it "reconfigured the power dynamics" of Chinese politics. What she calls "the urbanization of the local state" (Hsing 2010, p.6) had resulted in land and housing bubbles appearing in parts of China long before the onset of the crisis response defying attempts to control growth. Indeed, throughout 2007 and early 2008, monetary policy was tightened in an attempt to slow price rises. But the reversal of policy in response to the crisis resulted in a new boom as investment in real estate equally roughly 11.5 per cent of GDP in 2009 (Ma 2010).

With land and house prices rising dramatically in parts of China in 2009 and 2010, the need to slow the growth of housing and land price rises was urgent – partly because of its impact on inflation as a whole, partly because of growing public concern about being unable to get on the housing ladder, and partly because of the fears that bubbles were growing that would cause havoc if they were ever to burst. But many local governments depend on selling land for much of their income, and they took the opportunity of financial easing in 2009 to increase returns. Naughton (2010, p.32) notes that land revenues increased over 40 per cent in 2009, with the sale of rights to use land owned by the state accounting for RMB1.27 of the national total of RMB1.4 trillion in land revenues accounting for "about 44 percent of total budgetary revenues of all sub-national governmental units". Moreover, as noted above, the loans of local investment platforms are typically underwritten by expectations of rising land prices. So a deflating asset bubbles could end up in increasing the extent of nonperforming loans and also cutting a key source of finance for local governments. It's not impossible to square this circle – China's financial managers have dealt with problems like this in the past; but there are added complications in China that make the transition from expansion to economic retraction more difficult to achieve.

(Not) Changing the pattern of Growth

A second key difference between China and other states is that it is not just a matter of deciding when to move away from post-crisis expansion, but that this feeds into attempts to change the balance between consumption, investment and exports. The response to the crisis saw the emphasis in policy clearly swing back to growth promotion (at whatever costs). Within this growth promotion, there were elements intended to help the shift in emphasis; for example, support for rural consumption, support for clean energy technology projects, and infrastructure projects that should facilitate increased economic actability in central, southwest, and northern China. Indeed, in 2010, rural incomes grew faster than at any time since 1984, and faster than urban income growth for the first time in fifteen years (Li 2011). But as we have seen, they have also resulted in a return of excess investment and overcapacity and possible debt problems. So perhaps ironically, while the crisis might have further undermined confidence in the existing growth "model", the immediate solutions in some ways meant a turn back to that model rather than a further move to a new paradigm.

In the short term at least, there also seems to have been a slight retreat from the private sector and the market back to the state – though the evidence here is far from clear. For example, local protectionism seems to have increased with "buy local" projects instituted in a number of provinces and municipalities to try to make up for some of the decline in export markets, and to ensure that investment spurred production did not all simply result in a build up of inventories (Roland Berger 2010). The expansion of infrastructure spending also played a part, as the sector is overwhelmingly dominated by state enterprises. But it also seems that non-state SMEs found it difficult to get access to money to tide them through the decline in export markets even during this period of expansive bank lending.

In the second half of 2009, the idea of guojin mintui 国进民退 or "the expansion of the state, and the retreat of the private" began to gain increased attention in China. This was partly because of the above mentioned disparity in access to bank loans, which strengthened the state sector whilst leaving some private SMEs with nowhere to go other than bankruptcy (Bao 2010). But it was also because of an increase in acquisitions of private companies by state enterprises – including the acquisition of some of those that were finding it difficult to get other forms of funding to survive. The official position is that this is nothing to do with a preference for different types of ownership, but simply a result of the strong taking over the weak (Xie 2010), combined with changes to rules that allow, for example, greater state ownership in mining sectors (where private mines also have terrible safety records). Indeed, in March 2010, Premier Wen Jiabao presided over a State Council (2010) meeting to find new ways of bringing private investment into the state sector, including making it easier for private enterprises to gain access to finance and opening previously closed sectors. Nevertheless, the idea that the crisis has increased the role and power of state enterprises (Wines 2010) and that "the state is again ascendant" (Dean, Browne and Oster 2010) has gained credence in Western medias.

The Global Consequences of China's Crisis Management: Global Power and Local Responsibilities

The Chinese response to the crisis, then, has made it even more difficult to change the pattern of growth, resurrected and exacerbated some of the key structural problems in the economy, and helped inflate bubbles that need to be carefully deflated. Nevertheless, the goal of achieving 8 per cent growth – a task and a figure that have become something of a self-defined benchmark of the efficacy of CCP rule – was attained, with 10.7 per cent growth in the last quarter resulting in 8.7 per cent for the year as a whole. Not surprisingly, this success, when compared to what was happening in the West, has had a significant impact on China's place in the world, and Chinese perceptions of what role the country should play in the global order.

The initial response in China was to make it clear who was to blame for the crisis. From an outsiders point of view, the extent to which there was a sense in Beijing in early 2009 that China was being blamed for the crisis was a little surprising; the consensus in the US and Europe seemed to be that this was a crisis with its origins firmly and squarely in the West. But comments by Martin Wolf (2008) that hinted at Chinese mercantilism as the root cause of global imbalances, and suggestions that China's currency policy was a contributory factor (Weardon 2009) resulted in considerable anger in China – including from taxi drivers!

Having blamed Asia for its crisis in 1997, the West was perceived as not taking responsibility when its turn for a crisis had come. In response, China's top leaders, including Wen Jiabao (2009), were quick to assert that the origins of the crisis were not just Western but American, and the result of:

> inappropriate macroeconomic policies of some economies and their unsustainable model of development characterized by prolonged low savings and high consumption; excessive expansion of financial institutions in blind pursuit of profit; lack of self-discipline among financial institutions and rating agencies and the ensuing distortion of risk information and asset pricing; and the failure of financial supervision and regulation to keep up with financial innovations, which allowed the risks of financial derivatives to build and spread

As it began to appear that that China's own response to the crisis seemed to be working, there was also an upsurge in China in interest in the idea of a "China model" that might act as an alternative to Western modes of development. Qian Gang (2010) has traced the phenomenal rise in what he calls "the discourse of greatness" in 2008 and 2009, reflecting not just an interest but also a pride in China's apparent global economic power vis-à-vis the existing but crisis hit powers. Of course, this seems to contradict the apparent move towards a consensus that the Chinese model has run its course. But it can be reconciled, to an extent, by thinking about what the Chinese model means in most of these discourses. Rather than creating a clear idea of what the Chinese model is, it is more of a metaphor for doing it on China's terms and not doing it the western way; it is not big bank shock therapy liberalisation, it is not economic liberalisation accompanied by political democratisation and it is not doing what the international liberal global order wants you to do – for example, in liberalising financial sectors and allowing free floating market exchange rates. In short, while things need to change to make the model continue to work in the future, there is immense pride in China that it has helped restore China to a perceived rightful place at the top table of global affairs.

Moreover, the crisis has also resulted in a shift in the balance of power. The suggestion that China might dump its dollar holdings in an economic attack on the US goes too far; any such move would have serious and damaging consequences for China as well (Wu and Seach 2008); this would be a case of “mutually assured economic destruction”. But there has been a diversification away from the dollar with increased purchases of Yen and €400 million of Spanish government bonds. Indeed, there seems to be a concerted effort to utilise the financial crisis to increase investment and trade relations with countries like Greece and Portugal and strengthen China’s position in Europe as a whole (Anderlini and Spiegel 2010).

China does not have the financial power to stop the US selling arms to Taiwan, or to keep the Dalai Lama away from President Obama, or to stop Liu Xiaobo from winning the Nobel Peace prize – though the fact that 18 countries followed China in not attending the awards ceremony says something about China’s global influence. At the very least, there is now a balance of global economic power and the Chinese possess a significant counterweight to US economic pressure a powerful bargaining chip in any confrontation. As Drezner (2009) argues, China might not be able to compel the most powerful states to do what it wants, but it can at least deter them from trying to impose their wills on China. And this has been reflected in newly assertive Chinese positions on matters relating to external interference in sovereign national affairs (Swaine 2010a), and on Chinese territorial claims in the South China and East China seas.

China has also been more confident in asserting its discontent with the current global order, and the need for a greater say for developing countries towards ultimately parity with the developed world (Shambaugh 2010, Chin and Thakur 2010). To this end, membership of the G20 is an important signal of China's centrality in the creation of any reformed mechanism of global governance, but fundamental change can only come with reform of the international financial institutions. To this end, the change in quotas at the IMF were welcomed in China as a starting point – but according to Vice Foreign Minister Cui Tiankai nothing more than just a start; "This is not the end, not even the beginning of the end, but the end of the beginning" (China Daily 2010). But while China might be dissatisfied with the existing global order, and the "western" norms and preferences that underpins it, there are no signs yet of any attempt to destabilise the system (and thus undermine China's own economic interests); China might be a dissatisfied power, but it will express its dissatisfaction responsibly (Breslin 2010).

China's Global Role: Managing Expectations

But being a global power also brings expectations about providing global stability and global public goods. And it's fair to say that whoever was or wasn't responsible for the failings of the Copenhagen climate summit, it became a forum where different understandings of global responsibility and leadership clashed. Premier Wen Jiabao's speech at the summit made China's position very clear:

> Developed countries account for 80 percent of the total global carbon dioxide emissions since the Industrial Revolution over 200 years ago. If we all agree that carbon dioxide emissions are the direct cause for climate change, then it is all too clear who should take the primary responsibility. Developing countries only started industrialization a few decades ago and many of their people still live in abject

> poverty today. It is totally unjustified to ask them to undertake emission reduction targets beyond their due obligations and capabilities in disregard of historical responsibilities, per capita emissions and different levels of development (Bi 2009).

This understanding has implications beyond environmental concerns. In economic affairs too, the basic message is that it is far too soon to expect China to play a leading global role yet –it is the existing global powers that should continue to take the lion's share of global responsibilities. Even though China surpassed Japan to become the world's second largest economy in the second quarter of 2010, this does not mean that China is on a par with the USA and other western states, and it is unfair to expect too much from China. For example, in a letter to the Financial Times complaining about the way China was being depicted, the press officer at the Chinese embassy in London, pointed to the fact that China is still very much a developing country, is only 103rd in a league table of global per capita GNP, has over 150 million people living in poverty, and is reliant on foreign companies to produce most of its export value (Dai 2010).

Foreigners should not, then, try to force China to change – for example, to change the exchange rate policy. The task of reducing poverty and inequality is so great, that it is only right for China's leaders to privilege the developmental interests of its own people over the demands for equity from foreign businesses and governments. Moreover, resolving its own problems through the development of its own domestic demand is good for the rest of the world as well; by gradually becoming an alternative to declining Western consumption, China has become a "stabilizer" of the global economy (People's Daily 2010). And the crisis has helped put China's leaders in a position where they have more power to protect "core interests" (核心利益 hexin liyi) defined as maintaining the "state system and national security", "sovereignty and territorial integrity" and "the continued stable development of China's economy and society" (Swaine 2010b, p.4) than for many years; perhaps since the Treaty of Nanjing in 1842.

Conclusions: What Have We Learnt? Where are We Going?

Recent studies have reminded us not to think of China as having a single voice and a single interest when it comes to international relations (Shambaugh 2010, Jakobson and Knox 2010). Nevertheless, there does seem to be an increased confidence – some might even say overconfidence - in the Chinese way of doing things, and in China's ability to protect itself from foreign criticism and pressure. As Joseph Nye (2010) argues, we have not come to the end of US global power just yet, and suggestions that China has anything close to US the levels of power are misguided. But Nye also recognises that Chinese power really has increased, and in particular, that it might be in a position to challenge US dominance in Asia. China's leaders have not explicitly articulated their version of a Monroe Doctrine establishing the parameters of a sphere of influence where external powers have no right to be involved. But emboldened by the power transitions that have occurred – not just because of the global crisis, but perhaps highlighted by it – they do appear to be more self-assured in establishing what they consider to be China's rightful interests at home and in the region.

And the way in which the Chinese state mobilised the economy behind its objectives after November 2008 really was impressive. But it also exposed some vulnerabilities and weakness as well as strength. The response suggests that China's leaders do not feel they are in a position to cope with the political and social consequences of an economic slowdown – not a recession as such, but simply a reduction in the rate of growth. In this respect, we need to question whether it is possible to move to a new "scientific" paradigm built on slower but more sustainable growth – whether there is the political will to push forward with what in the long term is seen to be desirable, given the short term dislocations that this transition is likely to generate.

Indeed, in responding to the crisis, the leadership at best put the transition on hold, and in some areas took a couple of steps backwards. To be sure, there may be some long term progression towards increased domestic consumption and investment in environmental projects, but in terms of the expansion of finance, overcapacity, and potential banking problems, many of the problems that faced leaders at the beginning of the century are being revisited. What we seem to have learned, again, is that the Chinese economy is that inflating the Chinese economy is relatively easy – take local authorities off the leash and let them pursue their own local objectives. But what we have also learned over the years is that slowing growth is much more difficult. And to add an extra layer of complexity, any success in deflating bubbles might now come at the cost in increasing financial problems for local government investment platforms, and ultimately the banks. In the short run at least, it seems that a retreat back towards a (slightly) less open and (slightly) more state oriented economy is also underway.

The crisis has also confirmed that focussing on domestic issues will remain the primary focus of the government for some time to come. To be sure, this will have global ramifications. China's search for resources is driven by feelings of potential weakness and the need to find ways of ensuring the means of growing in the future. In addition to continued resource based investment, financial flows to the developed world have also increased – particularly in the search for technology and knowhow (and brands) that indigenous programmes have been rather slow in bringing forward. If what China does for its own sake has a collateral impact on global economic stability, then all well and good. But if what China needs goes against what others want – for example, in terms of currency policy – then what China needs and wants determine what China does.

References

Akyüz, Y., 2010. *Export Dependence and Sustainability of Growth in China and the East Asian Production Network*. Geneva: South Centre Research Paper, No.27.

Anderlini, J. and Spiegel, P., 2010. China Extends Help to Tackle Euro Crisis. *Financial Times*, 21 December.

Anderson, J., 2007. Is China Export-Led? UBS Investment Research Asian Focus, 26 September. Available at http://www.allroadsleadtochina.com/reports/prc_270907.pdf [Accessed 4 December 2008].

Bao, Yujun, 2010. Fitting in the Private Sector, *Caixin*, 20 April. Available at http://english.caing.com/2010-04-20/100137074.html [Accessed 13 October 2010].

Batson, A., 2010. China's Localities Feel Pinch of Tighter Credit. *Wall Street Journal*, 24 January.

Bi, Mingxin, 2009. Wen: Principle of ‘Common but Differentiated Responsibilities’ Must Never Be Compromised. Available at http://www.gov.cn/english/2009-12/18/content_1491072.htm [Accessed 18 April 2010].

Bradsher, K., 2010. Foreign Companies Chafe at China's Restrictions. *New York Times*, 16 May.

Breslin, S., 1999. The Politics of Chinese Trade and the Asian Financial Crisis: Questioning the Wisdom of Export-led Growth. *Third World Quarterly* 20 (6), 1179-1199.

Breslin, S., 2008. Do Leaders Matter? Chinese Politics, Leadership Transition and the 17th Party Congress. *Contemporary Politics* 14 (2), 215-231.

Breslin, S., 2010. China's Emerging Global Role: Dissatisfied Responsible Great Power. *Politics* 30 (s1), 52–62.

Chin, G. and Thakur, R., 2010 Will China Change the Rules of Global Order? *The Washington Quarterly* 33 (4), 119-138.

China Daily, 2010. Voting, Power Shift Just start of IMF Reform. *China Daily*, 5 November.

Chou, K.P., 2006. *Downsizing Administrative Licensing System and Private Sector Development in China: A Preliminary Assessment*. Tokyo: Asian Development Bank Institute Discussion Paper (52).

Cui, Li, Shu, Chang and Su, Xiaojing, 2009. *How Much Do Exports Matter for China's Growth?* Hong Kong: Hong Kong Monetary Authority China Economic Issues (1).

Dai, Qingli, 2010. Blaming China Exaggerates Her Power. *Financial Times*, 16 September.

Dean, J., Browne, A. and Oster, S., 2010. China's 'State Capitalism' Sparks a Global Backlash. *Wall Street Journal*, 16 November.

Drezner, D., 2009. Bad Debts: Assessing China's Financial Influence in Great Power Politics. *International Security* 34 (2), 7-45.

Dyer, G., 2008. Beijing Offers Just Quarter of Stimulus Funds. *Financial Times*, 14 November.

Fedelino, A. and Singh, R., 2004. Fiscal Federalism. *In:* E. Prasad (ed) *China's Growth and Integration into the World Economy*. Washington, D.C: IMF, 36-42.

Fewsmith, J., 1999. China in 1998: Tacking to Stay the Course. *Asian Survey* 39 (1), 99-113.

Gao, Peiyong, 1999. Further Improving China's Financial and Taxation System. *World Economy & China* (3-4):41 and 45.

Harding, J., 1997. Jitters in Beijing. *Financial Times,* 10 November.

He, Dong and Zhang, Wenliang, 2010. How Dependent is the Chinese Economy on Exports and in what Sense has its Growth Been Export-led? *Journal of Asian Economics* 21 (1), 87-104.

Hsing, You-tien, 2010. *The Great Urban Transformation: Politics of Land and Property in China*. Oxford: Oxford University Press.

Jakobson, L. and Knox, D. 2010. *New Foreign Policy Actors in China*. Stockholm: SIPRI Policy Paper (26).

Kennedy, J., 2007. From the Tax-for-Fee Reform to the Abolition of Agricultural Taxes: The Impact on Township Governments in North-West China. *The China Quarterly* (189), 43-59.

Koopman, R., Wang, Zhi and Wei, Shang-Jin, 2008. *How Much of Chinese Exports is Really Made in China? Assessing Domestic Value-Added when Processing Trade is Pervasive*. Cambridge, M.A: National Bureau of Economic Research Working Paper (141090.

Li, Cui and Syed, M., 2007. *The Shifting Structure of China's Trade and Production*. Washington, D.C: IMF Working Paper (07/214).

Li Yanping, 2011. China's Rural Incomes Climb Most Since 1984 Show Lure for Job Seeking Obama. *Bloomberg News*, 20 January. Available at http://www.bloomberg.com/news/2011-01-20/china-rural-incomes-rising-most-since-84-show-lure-for-job-seeking-obama.html [Accessed 21 January 2011].

Ljungwall, C., 2006. Export-led growth: Application to China's Provinces, 1978 – 2001. *Journal of Chinese Economic and Business Studies* (4), 109-126.

Ma, Qing-Ping, 2010. Housing Market in China's Growth Recovery and House Price Determination. Paper presented at the 21st CEA(UK) and 2nd CEA(Europe) Annual Conference, Oxford, July. Available at http://www.ceauk.org.uk/2010-conference-papers/full-papers/Qing-Ping-Ma-CEA-final.pdf [Accessed 22 December 2010].

Naughton, B., 2008. A New Team Faces Unprecedented Economic Challenges. *China Leadership Monitor* (26).

Naughton, B., 2009. Understanding the Chinese Stimulus Package. *China Leadership Monitor* (28).

Naughton, B., 2010. The Turning Point in Housing. *China Leadership Monitor* (33).

Nye, J., 2010. American and Chinese Power after the Financial Crisis. *The Washington Quarterly* 33 (4), 143-153.

People's Daily, 2008. China's 4 trillion Yuan Stimulus to Boost Economy, Domestic Demand. *People's Daily*, 10 November.

People's Daily, 2010. China, 'Stabilizer' of World Economy. *People's Daily* online, 2 February. Available at http://english.people.com.cn/90001/90778/90862/6885538.html [Accessed 2nd Feb 2010].

Qian, Gang, 2010. How Should We Read China's 'Discourse of Greatness'? China Media Project available at http://cmp.hku.hk/2010/02/23/4565/ [Accessed 8 December 2010].

Roland Berger, 2010. *Overcapacity in China*. Beijing: Roland Berger Strategy Consultants for the European Union Chamber of Commerce in China.

Shambaugh, D., 2010. Dealing with a Conflicted China. *The Washington Quarterly* 34 (1), 7-27.

Snyder, N. 2010. China's Monetary Response to the Great Recession. *In:* J. Connolly and M. Grubb (eds) *China and the Great Recession of 2007-2009*. Washington DC: Jackson School of International Relations, 86-100.

State Council, 2010. 国务院常务会议部署鼓励引导民间投资发展政策措施 Guowuyuan Changwuhuiyi bushu guili yindao minjian touzi fazhan zhengce cuoshi (State Council executive meeting policies to encourage and promote and encourage private sector development measures), 25 March. Available at http://fdi.gov.cn/pub/FDI/tzdt/dt/t20100325_119658.htm?fclose=1 [Accessed 4 September 2010].

Steinfeld, E., 2004. China's Shallow Integration: Networked Production and the New Challenges for Late Industrialization. *World Development* 32 (11), 1971-87.

Swaine, M., 2010a. Perceptions of an Assertive China. *China Leadership Monitor* (32).

Swaine, M., 2010b. China's Assertive Behavior, Part One: On 'Core Interests'. *China Leadership Monitor* (34).

Wang, Chong, 2009. 2009 Nian: Zhiyou Zhongguo Caineng Jiu Zibenzhuyi 2009 年。只 有 中国才能救资本主义 (2009: Can Only China Save Capitalism). *People's Daily Online Edition* (Chinese edition), 25 June. Available at http://world.people.com.cn/GB/9538683.html . [Accessed 27 June 2009].

Wang, Xinyuan, 2010. Local Government Debt Balloons. *Global Times*, 7 April. Available at http://business.globaltimes.cn/china-economy/2010-04/519528.html [Accessed 2 January 2011].

Wang, Yizhou, 2003 全球政治 和中国外交　探寻新的视角与解释 Quanqiu Zhengzhi he Zhongguo Waijiao: Tan Xun Xinde Shijiao yu Jieshi (Global Politics and Chinese Diplomacy: Exploring New Viewpoints and Explanations). Beijing: World Knowledge Press.

Wearden, G., 2009.) Obama Team Accuses China of Manipulating its Currency. *Guardian*, 23 January.

Wen, Jiabao, 2009. Special Message by H.E. Wen Jiabao. Speech to the World Economic Forum Annual Meeting, 28 January. Available at http://www.fmprc.gov.cn/eng/wjdt/zyjh/t536429.htm [Accessed 4 February 2010].

Wines, Michael (2010) "Make no Mistake: In China, State-Run Firms Rule: Despite Years of Private-Sector Growth, China Still Favors a Top-down Approach", *The New York Times*, 31st August.

Wolf, M., 2008. *Fixing Global Finance: How to Curb Financial Crisis in the 21st Century*. New Haven: Yale University Press.

Wu, F. and Seach, A., 2008. Would China's Sovereign Wealth Fund Be a Menace to the USA? *China & World Economy* 16 (4), 33– 47.

Wuttke, J., 2010. China is Beginning to Frustrate Foreign Business. *The Financial Times*, 7 April.

Xie, Weiqun. 2010. 并购是强进弱退而非国进民退 Binggou shi jiangjin ruotui erfei guojin mintui (Mergers and Acquisitions are the strong expanding and the weak retreating, not the state expanding and the private retreating). *People's Daily*, 5 March.

Yao, Yang, 2010. The End of the Beijing Consensus? Can China's Model of Authoritarian Growth Survive? *Foreign Affairs Online*, 2 February. Available at http://www.foreignaffairs.com/articles/65947/the-end-of-the-beijing-consensus accessed 5 March 2010 [Accessed 5 February 2010].

Yep, R., 2004. Can 'Tax-for Fee' Reform Reduce Rural Tension in China? The Process, Progress and Limitations. *China Quarterly* (177), 42-70;

Yeung, B., 2008. *New Thinking in Economic Security in China*. University of Warwick: Phd Thesis.

Yu, Yongding, 2006. A Look at China's Readjustment of Mode of Economic Growth. *People's Daily*, 22 August.

Yu, Yongding, 2009. China's Policy Responses to the Global Financial Crisis. Australian Government Productivity Commission Richard Snape Lecture. Available at http://www.eastasiaforum.org/wp-content/uploads/2010/01/2009-Snape-Lecture.pdf [Accessed 8 January 2010].

Zha, Daojiong, 1999. Chinese Considerations of 'Economic Security. *Journal of Chinese Political Science* 5 (1), 69-87.

Zhang, Xudong, 2002. The Making of the Post-Tiananmen Intellectual Field: A Critical Overview. *In:* Zhang Xudong (ed) *Whither China: Intellectual Politics in Contemporary China*. Durham, N.C.: Duke University Press, 1-76.

Zhang, Zhichao, Li, Wei and Shi, Nan, 2009. Handling the Global Financial Crisis: Chinese Strategy and Policy Response. SSRN working paper. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1377049 [Accessed 21 February 2010]

Zheng, Yongnian Chen, Mingjia (2009) How Effective Will China's Four Trillion Yuan Stimulus Plan Be? Nottingham University China Policy Unit Briefing Series, Issue 49. Available at http://www.nottingham.ac.uk/cpi/documents/briefings/briefing-49-how-efficient-4-tln-yuan.pdf [Accessed 4 January 2010].

Zhou, Xiaochuan, 2009. Reform the International Monetary System. Available at http://www.pbc.gov.cn/english/detail.asp?col=6500&id=178 [Accessed 21 February 2010]