CHINA'S ECONOMIC POLICIES: DELAYING THE CHOICES

DECEMBER 2019

Introduction

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The Central Economic Work Conference has just ended in Beijing, and its results were awaited with unusual trepidation by observers: how to counter the economic slow-down, what to do with the rising debt, could a new stimulus plan be launched, what about monetary policy and the currency's level? **The keywords now emerging are "stability" and "caution", with China's leadership clearly bracing for possible new trade shocks from the United States, and perhaps unwilling to respond with market reforms.** This issue of China Trends shines a light on three different types of trends in China's economy.

The first one, by Angela Stanzel, is on China's growth model. We hear of new developments: they are largely about technology upscaling, achieving "high quality development" through innovation. Yet, beyond an official optimism on growth rates, there are a lot of worries that surface: stagnation of income in China's middle class and slowing down of domestic consumption. **Two avenues of growth are encouraged: one is more financial support for SMEs.** The authors don't mention it, but this would be in practice a renewal of the short-lived calls for supporting the private sector that were heard in late 2018. **The other is an expansionary social spending policy** that would enable a renewed shift from forced savings and investment to consumption. But in a fashion that is typical of today's political trends, we hear no more about the role of the market or about liberalizing reforms.

Yet the issues still exist. Our second study, by Viviana Zhu, is on the fate of China's anti-monopoly law, enacted in 2008. Perhaps with some nostalgia, one source recalls the context of the reform era. **It took 20 years to pass the law – against views that a developing China actually needed more monopolies, not less, and a strong defense of "administrative monopolies", which extend far beyond the notion of natural monopolies in China.** That last contradiction has survived the law. While the notably liberal Unirule Institute (now closed for good) wished for more restrictions on these administrative monopolies, different state authorities struggled among themselves – and with SOEs often better connected politically.

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We can safely say that this issue's first two studies represent two trends of thought on Chinese economic policies. The first is technocratic and compatible with self-reliance: going upscale and expanding the social sphere are the answers to external headwinds and lower growth. The second is – implicitly only – a call for reform in response to external trade pressure, or *gaiatsu* as the Japanese called it during their era of difficult economic relations with the United States. **This is also an answer to the growing dissatisfaction abroad about China's state-led and subsidized economy, where private actors are less and less influential, unless they themselves become state-backed national champions.**

Thus, foreign pressure could be a factor, although both Xi Jinping and the party-state system seem to have resistance as a priority. Indeed, our third study gives a hardline view of China's posture throughout the trade conflict with the United States. Decoupling cannot happen, existing reforms provide room, and the Chinese economy is resilient. Our guest author, Jiakun Jack Zhang, rightly points out that this **optimism leaves aside what is still a low share for domestic consumption inside the Chinese economy, and increasing debt levels that now place limits on future spending.** Perhaps that is why some other Chinese experts still call for concessions to end the trade conflict.

Here too, there are two views, although one is granted a higher public profile.

About

China Trends seeks understanding of China from Chinese language sources. In an era where the international news cycle is often about China, having a reality check on Chinese expressions often provides for more in-depth analysis of the logic at work in policies, and needed information about policy debates where they exist. China Trends is a quarterly publication by Institut Montaigne's Asia program, with each issue focusing on a single theme.

CHINA'S NEW AND OLD ENGINES OF GROWTH

China's economic growth this year is believed to be the slowest since 1992. The National Institution for Finance and Development (NIFD), a Beijing-based think tank, recently predicted that China's economic growth rate would even slow below 6 per cent (to 5.8 per cent) in 2020, from an estimated 6.1 per cent this year. This is below China's target range of 6 to 6.5 per cent growth for 2019 and indicates further downward pressure on the Chinese economy. **Economists in and outside China are therefore pessimistic about the future outlook of China's growth.** Yu Yongding, a former president of the China Society of World Economics and director of the Institute of World Economics and Politics at the Chinese Academy of Social Sciences (CASS), believes that the "downward trend is riskier than many observers seem to realize" for instance.[1]

Contrary to these bleak predictions, the two authors introduced in this article are still optimistic that the Chinese economy will grow at a reasonable speed if the government focuses on the right economic policies. While Zhang Deyong, a researcher at the Institute of Financial and Economic Strategy of the CASS, places hope on new engines of growth, Li Xunlei, chief economist of Zhongtai Securities and vice chairman of the China Chief Economist Forum, focuses on the traditional drivers of economic growth.

Zhang finds in his analysis that **the Chinese economy grew fairly well in the first half of 2019, despite the uncertainties in the external environment and the downward pressure on the economy.**[2] As of May of this year, 5.97 million jobs have been created in urban areas. In addition, production has stabilized and progressed, the service industry maintained a rapid growth; domestic demand continued to expand, and online retail continued to experience rapid growth.[3] Zhang says that exports have maintained a rapid growth and that the trade surplus further expanded. The second assertion is spot on; but his estimate of China's exports sounds optimistic: according to MOFCOM, "In January-September 2019, China's total import and export value reached US$3351.78 billion, with a decrease of 2.4% year-on-year (the same as below). The exports were US$1825.11 billion, with a decrease of 0.1%, and the imports were US$1526.67 billion, with a decrease of 5%. The trade surplus was US$298.43 billion, increasing by 36.1%."[4]

As the Chinese economy moves towards high-quality development, innovation has become the first driving force for development.

As the Chinese economy moves towards high-quality development, **innovation has become the first driving force for development, Zhang writes, leading to the vigorous development of the "three new" economies ("三新"经济): new industries, new formats, new business models (新产业、新业态、新商业模式).** These new economies are based on innovation, and have been supported in various ways by digitalization, artificial intelligence, big data or online retail. In 2017, the growth value of the "three new" economies was equivalent to 15.7 per cent of GDP growth, 0.4 percent higher than in 2016, and 2.9 percent higher than the current GDP growth rate.

Angela Stanzel

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1. Yu Yonding, "China Needs to Arrest Slowing Economic Growth, And it Has the Means to Do So," *South China Morning Post*, 7 November 2019, https://www.scmp.com/comment/opinion/article/3036521/china-needs-arrest-slowing-economic-growth-and-it-has-means-do-so

2. Zhang Deyong, "Grasp the 'Real' and 'Potential' of China's Economic Development" 全面把握中国经济发展的"实"与"势," *Wisdom China 智慧中国*, September 2019.

3. Online retail sales rose by 16.8% year-on-year over the period January and August (though down from the 28.2% growth the year before), according to data published last month by the National Bureau of Statistics.

4. Ministry of Commerce of the People's Republic of China, "Briefing on China's Import & Export in September 2019," *MOFCOM*, 11 October 2019, http://english.mofcom.gov.cn/article/statistic/BriefStatistics/201911/20191102912682.shtml

In line with these "three new" economies Zhang sees a continuous emergence of new consumption models. Although the growth rate dropped by 0.5 percent from January to April, the investment in high-tech industries increased by 11.9 per cent year-on-year. Investment in the manufacturing industry focusing on the digital transformation (Industry 4.0) increased by 15 per cent. Zhang highlights that, since the beginning of 2019, the high-tech industry has grown rapidly. In May, the added value of high-tech manufacturing increased by 9.4 per cent.

Zhang therefore argues that China's economic growth is stable and that the long-term positive trend will not change. He believes that continued comprehensive reform and opening-up, as well as continuous systemic institutional innovation will keep the Chinese economy growing. **Zhang recommends that China promotes high-quality development, adheres to the supply-side structural reforms, and deepens reforms in key areas.** He also warns that China should pay more attention to rules and other institutional openness as well as further ease market access.

The reason behind consumers' lack of optimism is the stagnating disposable income of residents.

Li Xunlei's analysis starts on a much less optimistic note than Zhang's. **Li uses what he calls the "troika" (三驾马车) architecture to explain China's recent economic performance: consumption, investment and foreign trade.** In the first half of 2019, China's GDP growth rate was 6.3 per cent.[5] In terms of total volume, GDP growth was in line with the 6-6.5 per cent proposed by the government's work report at the beginning of the year.

However, Li sees in the consumption growth rate a downward trend. In 2018, the total growth rate of retail sales of consumer goods was around 9 per cent, and the average growth rate in the first half of 2019 fell to 8.4 per cent. The total retail sales of consumer goods reached 9.8 per cent in June, but this was mainly driven by the automobile industry.[6] Other consumption growth rates, including the service industry, were still weak. The *consumer price index* of the service industry dropped from three to less than two per cent.

Li believes that the reason behind consumers' lack of optimism is the stagnating disposable income of residents. Li finds that the trend of income growth is very similar to the trend of growth of total retail sales of consumer goods. However, while in 2018 the per capita disposable income of high-income groups increased by 8.8 per cent, middle-income groups achieved a growth of only 3.2 per cent. **If inflation is considered, the income growth of middle-income groups is almost equal to zero. This is the main reason for the slow domestic consumption,** in Zhang's view. In addition, the consumption structure has diverged. The consumption of high-end consumer goods and luxury goods has grown rapidly.

Secondly, regarding investment, the growth rate of manufacturing investment in China's fixed asset investment fell to three per cent during the first half of 2019. This indicates that the slowdown of investment in the manufacturing industry and the lack of domestic demand and rising labor costs are all related, Li explains. Regarding the growth rate of real estate investment, it was 10.9 per cent, which has become the main factor for stabilizing the growth of fixed asset investment. As for the growth rate of infrastructure investment, it was relatively weak, only around 4 per cent. **Li believes that it will be unrealistic to stimulate economic growth through infrastructure investment in 2019.**

5. Li Xunlei, "How to Treat China's Economic Operation and Policy Trends in 2019 如何看待2019年中国经济运行与政策趋势," *Journal of Contemporary Financial Research 当代金融研究* 4, 2019, no.13.

6. The reason for such a large increase was the June 30 deadline to sell cars built to China-5 emissions standards. The central government had ramped up its anti-pollution drive last year and has aggressively pursued the adoption of the electric cars and its stage-6 emission standards. After the deadline only vehicles meeting new stage-6 standards could be put up for sale. The China-5 emissions cars had been reduced in price and the sales volume therefore rose sharply.

Finally, regarding foreign trade, contrary to Zhang, Li finds that exports were generally weak in 2019, likely due to increased trade friction between China and the United States. In sum, during the first half of the year, these three drivers were tempered. Therefore, even though the current economic downturn is not large, it can maintain a steady downward trend.

Li suggests focusing on solving structural problems in response, such as expanding the proportion of public spending that is allocated to social security. Increasing future social security funds would increase consumer confidence and thus also consumption rates. In terms of taxes and fees, Li sees the necessity to further reduce the financing costs for small and medium-sized enterprises (SMEs) and to implement corresponding supporting policies. According to him, **"instead of just shouting slogans, there need to be practical steps" (而不是只是喊口号, 需要有实际的举措)**.

Li notes that in the future, like most developing countries such as the United States or Japan, the Chinese economy will be driven by consumption, but the main force of consumption is the middle and low-income classes, which are currently growing relatively slower than the upper middle class. In consequence, for his next policy recommendations, Li proposes to firstly reduce the actual interest rate level, so that SMEs can reduce the financing cost, which would then increase employment and the income of the middle and low-income groups especially.

In addition, it is necessary to achieve balanced social development through public spending in Li's view. At present, the level of debt in the residential sector is rising rapidly and the debt level of the corporate sector is almost the highest in the world. **There is a need for enterprises and the residents' sector to stabilize their debts, in particular as the population ages further and the debt level in the whole society only rises.** Li believes that solely the central government, which has very large available assets, can hedge the rise in the debt ratio of the residents and the corporate sector.

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Improved social security would in turn also encourage residents to consume more. Li finds that Chinese citizens are worried about their future pensions, financing their children's education. This is why they do not dare to consume. **The core reason for the high savings rate of Chinese residents is the concern for future social welfare protection.** Li suggests using the large state-owned resource to cover the needs of the Chinese economy in the future, such as the social security gap. He argues that profits of State-Owned Enterprises (SOEs) can be turned over, meaning to transfer equity, which is a big advantage of China's SOEs system.

In conclusion, given the various challenges China faces from within and outside, it seems Beijing will have to do both: encourage the new engines of growth as well as tackle the problems that are rooted in the traditional drivers of growth.

CHINA'S ANTI-MONOPOLY LAW: MORE THAN JUST A PIECE OF PAPER?

The 2008 anti-monopoly law is the guardian of the modern market economy, writes Shi Jichun, professor at Renmin University's School of Law.[7] Since the anti-monopoly law is based on the existence of a market economy, there was no space for it during China's planned economy era. However, **with the introduction of the market-oriented economic reforms and the introduction of the market competition mechanism, China needed a legal context to oppose monopolies and safeguard competition,** eventually leading to the birth of the anti-monopoly law in 2008. The legislation of the anti-monopoly law in China was a "liberalization of mind, deepening of the market economy concept into people's hearts (深入人心) and a huge step in the establishment of fair competition", declares Wang Xiaoye, researcher at the Institute of Law (Chinese Academy of Social Sciences).[8]

The adoption of the anti-monopoly law was a milestone in China's economic reform, and a significant part of China's attempt to improve its socialist market economy since the Deng Xiaoping era. In 1978, realizing the increasing gap between China and developed countries, Deng announced the Open-Door Policy. **The logic behind it was simple: if China "closes its door and refuses to make any progress (关起门来，固步自封)", it will never develop.**[9] In addition, the opening-up of China had to be complemented with domestic reforms, for it to increase its capacity to engage the world.

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During the past decades, according to Zhang Zhuoyuan, researcher at the Institute of Economic (Chinese Academy of Social Sciences), China's economic reform has followed two main lines of policy.[10] The first one, focusing on the consolidation of the socialist economic system, has three key aspects. Firstly, it gave the green light to individual and private economies, which had ceased to exist due to the earlier transition to socialism (1953-1957). China found itself in a situation where it had abundant labor but no jobs available (人浮于事).[11] The country was in need of 20 million new job positions every year.[12] The second aspect was the establishment of Special Economic Zones. **Despite the lack of clarity over whether they should "follow capitalist or socialist characteristics (姓资还是姓社)", the Special Economic Zones were considered to be essential to attract foreign investments, advanced technology acquisition, and trade increases.** They were also seen as an opportunity to observe and learn from capitalism. Finally, there was the reform of corporate ownership, a structure that created mixed responsibilities for state and enterprises.

The other main line of policy is the transition from a planned economy to a market economy, which allowed market-based resource allocation. The goal was to create a tailored system that takes advantage of both effective market

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7. Shi Jichun, "Anti-Monopoly Law and Socialist Market Economy《反垄断法》与社会主义市场经济," *The Jurist,* No. 1, 2008, http://www.cssn.cn/fx/fx_jjfx/201503/t20150311_1541380.shtml

8. Zhao Xin & Zhou Guohe, "The Anti-Monopoly Law Is a Milestone in China's Economic System Reform 反垄断法是中国经济体制改革的里程碑," *Shenzhen Special Zone Press,* 24 September 2019, http://theory.workercn.cn/244/201909/24/190924094841281.shtml

9. "Deng Xiaoping and the Third Plenary Session of the 11th CPC Central Committee 邓小平与中共十一届三中全会," *en.people.com,* 23 January 2019, http://dangshi.people.com.cn/n1/2019/0123/c85037-30586524.html

10. Zhang Zhuoyuan, "The Two Main Lines of China's Economic Reform 中国经济改革的两条主线," *Social Sciences in China 中国社会科学,* No. 11, 2018 http://www.cssn.cn/zx/201908/t20190824_4961702.shtml

11 "Deng Xiaoping and the Third Plenary Session of the 11th CPC Central Committee 邓小平与中共十一届三中全会," *en.people.com,* 23 January 2019, http://dangshi.people.com.cn/n1/2019/0123/c85037-30586524.html

12. Zhang Zhuoyuan, "The Two Main Lines of China's Economic Reform 中国经济改革的两条主线," *Social Sciences in China 中国社会科学,* No. 11, 2018 http://www.cssn.cn/zx/201908/t20190824_4961702.shtml

(有效市场) and active government (有为政府).[13] In other words, to let both the "invisible hand (看不见的手)" of the market and the "visible hand (看得见的手)" of the state to play their role.[14] Previously, in the Mao era, the potential of the market was ignored, leaving it no role to play, until it became a passive market with no bottom up influence whatsoever.[15] A significant element of this market economy transition is the anti-monopoly law, which was approved in 2007 and took effect on August 1, 2008. However, China still lacks the culture of free competition, besides awareness of companies, government and public with regard to anti-monopoly.[16] This was also the reason why the legislation process was extremely complex and took twenty years of effort (1987-2007).

During the legislation process, the strategy of both "going out" (走出去) to and "inviting in" (请进来) other countries was adopted.[17] In other words, the team drafting the law traveled to countries that had an advanced anti-monopoly law, such as Europe, the United States, Australia and Japan, to learn from their experiences. At the same time, the draft law was shared with foreign experts and officials for comments and advice. However, two major obstacles were encountered. The fundamental one was the law's applicability to the Chinese system. As Wang recalls, some scholars were against the idea, concerned as they were that the size of Chinese companies was too small compared to U.S. large-scale companies. They believed that China even needed to promote monopolies to foster the emergence of big companies. Wang, however, points out that others argued in favor of the anti-monopoly law.

> *The government's administrative monopoly restrains the competition far more than the companies.*

The other obstacle was how to deal with the existing administrative monopoly. The interests of State-Owned Enterprises (SOEs), created during the era of planned economy, were highly linked with the interests of the executive branch. With the support of the state, they already have a monopoly in their respective sector. Therefore, both the SOEs and the executive branch hoped to be exempted from the law. The government's administrative monopoly restrains the competition far more than the companies. **If the government is not restrained from impeding competition, then the anti-monopoly law would likely be "just a piece of paper (花瓶)".**[18] Hence, even though the part covering the issue of administrative monopoly was deleted from the first law draft of 2005, the later version inserted it back in.

However, the inclusion of administrative monopoly did not solve the issue of monopoly of SOEs. Xu Xiaosong, Deputy Director of the Institute of Economic Law (University of Political Science and Law of China), advocates for a separate anti-monopoly regulatory framework focusing on SOEs.[19] She points out that SOEs and the existing anti-monopoly law are fundamentally incompatible, as SOEs are created by the state to intervene in the market, not to contribute to market competition. In addition, Article 7 of the anti-monopoly law creates a duty for the state to protect business activities related to the state-owned economy. Xu interprets this as a recognition of the legitimacy of the SOEs' monopoly status. **A study published by Unirule Institute of Economics in 2012 also addresses the problem of Article 7.**[20] **It considers the Article absolutely redundant (画蛇添足), and a source of misunderstanding.** For instance, "monopoly related to the lifeline of the national economy" should not constitute a category by itself. However, the study explains, contrary to the view of Xu, that from a strict legal perspective, the anti-monopoly law does not exempt administrative monopoly; still, further measures are required to break administrative monopolies. Among these measures is the withdrawal of SOEs' from profit-making sectors.

13. YLin Yifu, "Achievements, Experiences and Challenges of China's Economic Reform 中国经济改革的成就、经验与挑战," *Economic Times,* 29 December 2018, http://www.cssn.cn/zm/201812/t20181229_4803850.shtml

14. "Exploration and Enlightenment of the Economic System over the Past 70 Years 70 年来经济体制的探索与启示," *Economic Times,* 16 September 2019, http://theory.people.com.cn/n1/2019/0916/c40531-31354094.html

15. *Ibid.*

16. Shi Jianzhong, "Tenth Anniversary of the Anti-Monopoly Law: Effectiveness of Implementation and Direction for Strengthening 反垄断法十周年:实施成效与强化方向," *Guangming Daily,* 29 July 2018, http://www.cssn.cn/jjx/jjx_gd/201807/t20180729_4512809.shtml

17. Wang Xiaozhang, "My Anti-Monopoly Law Research Path 我的反垄断法研究之路," *Iolaw.org,* https://www.iolaw.org.cn/showArticle.aspx?id=3687

18. Zhao Xin & Zhou Guohe, "The Anti-Monopoly Law Is a Milestone in China's Economic System Reform 反垄断法是中国经济体制改革的里程碑," *Shenzhen Special Zone Press,* 24 September 2019, http://theory.workercn.cn/244/201909/24/190924094841281.shtml

19. Sun Jin & Zhang Tian, "Thoughts on the Application of the Anti-Monopoly Law to Monopoly of SOEs 关于《反垄断法》对垄断国企适用问题的思考," *Research on Rule of Law,* No. 8, 2014, http://www.cssn.cn/fx/fx_jjfx/201410/t20141008_1352808.shtml

20. "The Causes, Behaviors, and Termination of Administrative Monopoly in China 中国行政性垄断的原因、行为与破除," *Unirule Institute of Economics,* 2 August 2012, https://unirule.cloud/index.php?c=article&id=3334

From 2008 to 2018, 164 monopoly agreement cases and 44 market dominance abuse cases have been investigated and treated.[21] Over the issue of anti-monopoly, China has its latecomer advantage (后发优势), allowing it to learn from other countries experiences and improving its enforcement capability step by step.[22] In 2018, the State Administration for Market Regulation was established, which is under the direct supervision of the State Council, to address the enforcement issue of the anti-monopoly law. Previously, the enforcement power was spread across the Ministry of Commerce, the National Development and Reform Commission, and the State Administration for Industry and Commerce. **The three authorities were "seemingly in harmony but actually at variance" (貌合神离), due to their difference in priority and area of expertise.**[23] Moreover, given a level of authority that is only at the bureau level (局), they tended to "have hearts but lack the strength (心有余而力不足)" when dealing with some SOEs that had higher rank, meaning they did not have the power to interfere with the activities of these SOEs.[24] Following its establishment, in July 2019, the Chinese State Administration for Market Regulation issued three regulations[25] that are supplementary to the anti-monopoly law. These regulations increase the practicality and transparency of the anti-monopoly law.[26]

From 2008 to 2018, 164 monopoly agreement cases and 44 market dominance abuse cases have been investigated and treated.

Apart from the improvement above, an amendment of the 2008 law is also underway. The preparation for the draft has been completed, and it is now in the consultation phase. As stressed by Liu Zhicheng, researcher at the Chinese Academy of Macroeconomic Research, updating the law is urgent.[27] **The current version can no longer keep up with the new emerging forms of competition and monopoly.** In addition, there are still many industries that are highly regulated and restrict foreign investment: for instance, the oil, power and communication industry. Developed countries have more competition in these sectors, resulting in more commodity price flexibility and more services options. China's market reform is insufficient and is lagging behind Europe and the United States.[28] Making the anti-monopoly law more effective, both in terms of the willingness to implement it and enforcing it, remains a pressing issue.

As Xi Jinping said during his speech at the 40 years anniversary conference of China's reform and opening-up, these symbolize the awakening of China, but there is still a long way to go.[29] However, with the current attempts to create Chinese champions in certain sectors, it is unclear whether China's and Xi's real intentions is to create a fair market competition, or to prevail over its global competitors. There may be more clarity on the actual direction sought in policy terms when the amended version of the anti-monopoly law is published.

21. Shi Jianzhong, "Tenth Anniversary of the Anti-Monopoly Law: Effectiveness of Implementation and Direction for Strengthening 反垄断法修订要解决执法中最迫切问题," *Guangming Daily,* 29 July 2018 http://www.gov.cn/zhengce/2018-11/17/content_5341255.htm

22. Shi Jianzhong, "Tenth Anniversary of the Anti-Monopoly Law: Effectiveness of Implementation and Direction for Strengthening 反垄断法十周年:实施成效与强化方向," *Guangming Daily,* 29 July 2018, http://www.cssn.cn/jjx/jjx_gd/201807/t20180729_4512809.shtml

23. *Ibid.*

24. "Speeding Up the Merger of Three Anti-Monopoly Authorities 反垄断机构"三合一"全面提速," *Xinhua,* 25 May 2018, http://www.xinhuanet.com/fortune/2018-05/25/c_1122886715.htm

25. Interim Regulation Prohibiting Monopoly Agreement (禁止垄断协议暂行规定), Interim Regulation Prohibiting Conduct Abusing Dominant Market Positions (禁止滥用市场支配地位行为暂行规定),Interim Regulation Preventing Conduct Abusing Administrative Rights to Eliminate or Restrict Competition (制止滥用行政权力排除、限制竞争行为暂行规定)

26. "Three Supporting Regulations Are About to Be Implemented 三部配套规章实施在即," *Xinhua,* 12 July 2018, http://www.xinhuanet.com/fortune/2019-07/12/c_1210191674.htm

27. *Ibid.*

28. "Analysing China's Economic System Reform and Economic Growth 浅析中国经济体制改革与经济增长," *Modern Business Magazine,* No. 3, 2019, http://www.xdsyzzs.com/guanlizongheng/5022.html

29. "Speech at the 40th Anniversary of Reform and Opening 在庆祝改革开放40周年大会上的讲话," *Xinhua,* 18 December 2018, http://www.xinhuanet.com/politics/leaders/2018-12/18/c_1123868586.htm

IMPACT OF THE TRADE WAR ON THE CHINESE ECONOMY

The United States and China are locked in the largest trade war since the Smoot-Hawley Tariff of 1930. The average tariffs levied on Chinese goods have risen from 3 per cent in January 2018 to over 20 per cent in September 2019, and could cover all Chinese exports in December if the two sides fail to reach a "phase one deal." China's rapid economic growth in the last several decades would not have been possible without the influx of foreign direct investment (FDI) and surge in exports following its accession to the World Trade Organization (WTO) in 2001. **The trade war threatens to reverse these decades old trends and put downward pressure on Chinese economic growth.** The official 6 per cent growth in Q3 2019 is the slowest growth since Q1 1992, when China began publishing quarterly growth data, while the true numbers are likely to be significantly lower.

Nevertheless, most Chinese scholars remain strident in their public statements about China's prospects in the trade war. Professor Song Guoyou at Fudan University's School of International Relations and Public Affairs advocates taking a hard line towards the United States and to "fight back" (应战敢战善战).[30] He acknowledges that the trade war has adversely impacted business operation but "from a holistic and long-term perspective, this impact is overall. **It is controllable, and the comprehensive advantages of China's economic development are obvious."** These comprehensive advantages (综合优势) he is referring to include the leadership of the Chinese Communist Party, the expanding domestic consumer market, increasingly sophisticated infrastructure, and extensive connections with the global economic system. He identifies the desire to maintain American hegemony in the face of a rising China as the root cause of U.S.-China trade frictions. As such, the American leadership's rhetoric in the liberal international order is but a disguise for its selfish pursuit of national interest. The analysis makes no mention of the merits of various substantive policy issues involved in the U.S.-China trade negotiations such as intellectual property protection, forced-technology transfer, industrial policy, and market access.

The American leadership's rhetoric in the liberal international order is but a disguise for its selfish pursuit of national interest.

Professor Zhong Maochu of the Institute of Economics at Nankai University, is similarly confident in China's ability to cope with escalating trade frictions with the United States. He argues that the high level of economic interdependence between the two economies make full decoupling (脱钩) or the comprehensive suppression of the Chinese economy prohibitively difficult.[31] At the same time, he expresses confidence that **the reform of China's economic system gives it the ability to digest transaction costs caused by trade frictions.** Zhong also extols the size and resilience of the Chinese economy, its well-developed infrastructure system, and the virtues of China's consumer-facing technology industries. He also heaps praise on China's experienced macroeconomic decision-makers who helped formulate a "rational and effective response strategy" to cope with the 2008 Global Financial Crisis.

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30. Song Guoyou, "To End the War, China Should Fight, Must Dare to Fight, And Can Fight Well," *People's Daily 人民日报*, 29 August 2019, http://opinion.people.com.cn/GB/n1/2019/0829/c1003-31323709.html

31. "Zhong Maochu, "China's Economy Is Fully Capable of Coping with Escalating Sino-US Economic and Trade Frictions," *Specials 特别策划*, 14 June 2019.

Zhong, like Song, frames his narrative around American decline and portrays the trade war as an attempt by the U.S. to blame China for its own economic mismanagement. He identified the root causes of America's economic problems in the hollowing out of manufacturing, heavy debt burdens, excessive consumption, and trade deficit-are due to its long-term accumulation of the global currency status of the U.S. dollar. **While it is true that China did not cause these problems, the author does not acknowledge that China's own export-oriented growth model was made possible by many of these policies.** The role of American FDI in China does not feature in his narrative.

Instead, Zhong argues that the United States cannot afford to exclude China from the "full industrial chain" (全产业链) because its own economic system cannot bear its heavy price, and can only target China's "shortcomings" (短板) with trade barriers. While he does not provide specific examples of these "shortcomings," he is most likely referring to Chinese technology companies placed on the U.S. entities list. Zhong argues that the most critical path to "make up for shortcomings" is to replace the industries affected by economic and trade frictions by developing new industries.[32] **This somewhat controversial recommendation amounts to fighting decoupling with decoupling and an implicit endorsement of the indigenous innovation industrial policies that led many U.S. multinationals to endorse the Trump administration's trade war.** Zhong also endorses the promotion of a RMB-based international trading system without acknowledging the inherent tensions between weakening the RMB to support exporters (which is what the PBOC has been doing) and strengthening the RMB to increase its attractiveness as a reserve currency.

32. *Ibid.*

The United States cannot afford to exclude China from the "full industrial chain" (全产业链) and can only target China's "shortcomings" (短板).

Professor Chen Yuanqing of the School of Economics of Tianjin Normal University also calls for strengthening science and technology innovation as a way to deal with U.S.-China trade frictions.[33] He writes that the disruption of manufacturing by technological advances has driven the field of scientific and technological innovation into an arena of strategic competition between the two countries and acts as an essential motivation behind the trade war. Unlike Zhong, **Chen urges that China should strive to "build an innovative country" (建立创新型国家) and become a "major technological power" (科技强国) by adhering to WTO rules and by taking the initiative to implement reform and opening up.**

33. *Ibid.*

Chen criticizes the United States' practice of unilateralism and protectionism as going against the tide of globalization. But his policy recommendations to create an "independent innovation capability system" (自主创新能力体系) leave more room for foreign participation. He urges China to expand FDI and cultivate multinational enterprises with global innovation capabilities. He advocates for strengthening international technology exchanges and cooperation and for building world-class innovation platforms based on domestic universities and research institutions. However, he does not sideline government involvement in the economy to promote innovation. Instead, **he calls for the use of "reasonable industrial policies" (合理的产业政策) to guide domestic capital into the high-end industrial chain of global emerging industries and become multinational enterprises with global innovation capabilities.** He argues that the government must play a role in basic research, in licensing technology, in encouraging enterprises to seize opportunities in emerging industries, and in investing in higher education. By strengthening investment and policy guidance, Chen argues, China can build a world-class university and research institution, rely on it to conduct independent research and development of technology, and cultivate innovative talents and high-quality laborers. According to this view, the government plays a mediating role between social capital and corporate capital to encourage innovation.

Notably absent in these assessments of the trade war's impact are hard figures about China's economic performance or acknowledgement of the trade-offs inherent in government intervention in the economy. In 2018, China sent nearly 20 per cent of its exports to the U.S. and domestic consumption made up for only 39 per cent of GDP compared to 69 per cent for the United States. Other recent data show that China is leaning more heavily on the state sector for fixed asset investment (which is also slowing dramatically and trade, consumption, and investment are all down). At the same time, **domestic pressure is building for the government to ease monetary policy or ramp up government spending to stimulate growth, which could exacerbate China's debt hangover.** Beijing is trying to make up for these structural disadvantages with political resolve and has thus curtailed the scope of permissible public discourse accordingly.

Above all, the trade war is a strategic game. If the U.S. agrees to lift tariffs, then China does not have to face these difficult policy trade-offs; but the U.S. would have no reason to lift tariffs if it believes that China will capitulate. Thus, **as this war of attrition drags on past 500 days, both economies are hurt but have the incentive to hold out until the other side gives in.** This may be one reason that scholars publishing in less visible outlets behind academic journal paywalls have adopted a much more conciliatory tone. For example, Professor Liu Feng of the Institute of International Relations at Tsinghua University[34] has recently called for scholars and policy makers in the U.S. and China to jointly explore how to effectively manage strategic competition and avoid long-term systematic confrontations. It is also worth noting that Song's People's Daily op-ed is framed against the view that "China should not fight back" and "make every effort to meet U.S. demands." While he denounces this view as "obviously wrong, naive, and very harmful," this framing acknowledges the debate exists and is worthy of rebuttal. The full diversity of Chinese academic assessments of the trade war's impact are thus difficult to measure with state-sanctioned sources and not adequately represented by the three authors profiled in this article.

Notably absent in these assessments of the trade war's impact are hard figures about China's economic performance.

34. Liu Feng, "Limits and Management of Sino-US Strategic Competition," *Contemporary International Relations 现代国际关系*, 2019, http://mall.cnki.net/magazine/Article/XDGG201910003.htm

Notes

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