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China's Change of Economic Model: Not So Fast!

POLICY PAPER JUNE 2022

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There is no desire more natural than the desire for knowledge

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TABLE OF CONTENTS

INTRODUCTION

Two surprise news recently came in.

The first came in on June 9 with China's release of its May customs data. After three straight months of decline, China's exports rebounded sharply in May with a 16.9% rise YoY, and a 78 billion USD trade surplus to boot.[1] **This upsurge is so sharp as to create skepticism:** matching statistics from importing countries, and another month of upsurging exports, will be useful for confirmation. There are also other signs of rebound: industry output recovered from its slide with a light 0.7% YoY increase, and fixed-asset investment increased somewhat. However, neither consumer spending nor real estate sales followed this positive trend: this is what some observers call the beginning of a lopsided recovery.[2] **China's export bonanza that amplified with the pandemic has now resumed.** It is even less matched than previously with a corresponding domestic demand for imported products.

For China's partners, it is important to have the May rebound in export confirmed, after the procurement conundrum of the past few months. **This recovery is good for the global supply chain, even as it puts away the transition towards a consumer and service economy based on household income.** Of course, these vagaries also illustrate the need for diversification of procurement away from China.

The second news is that **China's coal and LNG imports are declining.** Its January to May YoY oil imports also declined by 1.7%, even though for the month of May they climbed back YoY by 11.8%.[3] And although oil shipments from Russia are sharply increasing in May, up to that month China had turned more to Saudi Arabia as a source. India's oil purchases from Russia have seen a much steeper rise. Stocks are now replenished. There is a shift back to domestically mined coal for electricity production. Low domestic growth is of course a factor which can reverse itself. China may have been waiting for even better price terms from Russia: from a low base, its purchases shot up in May, although still behind India's.[4]

1 "Table of total value of import and export commodities trade in May 2022 (in USD) ((2)2022年5月进出口商品贸易方式总值表(美元值))", *General Administration of Customs. P.R.China*, June 6, 2022, http://www.customs.gov.cn/customs/302249/zfxxgk/2799825/302274/302275/4381844/index.html
2 Dragonomics Team, "A Lopsided Recovery Begins", *Gavekal Dragonomics*, June 15, 2022, https://research.gavekal.com/teaser/a-lopsided-recovery-begins/
3 Chen Aizhu, Emiliy Chow, "China May crude oil imports edge up, but refined oil product exports slump", *Reuters*, June 9, 2022, https://www.reuters.com/business/energy/china-may-crude-oil-imports-edge-up-12-year-ago-2022-06-09/
4 "China May oil imports from Russia soar to a record, surpass top supplier Saudi", Reuters, June 20, 2022, https://www.reuters.com/markets/commodities/chinas-may-oil-imports-russia-soar-55-record-surpass-saudi-supply-2022-06-20/

From these two developments of the past month, the background of the previous few months' sharp economic downturns, and China's previously successful economic path through two years of pandemic, some observations can be made on **China's current and future economic path.**

WHAT IS THE LONG-TERM VS. THE SHORT-TERM TREND?

The short term trend is again shifting – from the Zero-Covid induced downturn to at least a partial recovery. If one adds a low cost energy mix to the moderate depreciation of the renminbi since March, this allows for two deductions: so far, **China is not among the causes of the worldwide energy price rise, and it suffers less than others from this inflation.** What it takes from Russia undermines G7 (and Australian, Korean and Singaporean) sanctions, but also diminishes global pressure on other sources of energy supply. Simultaneously, China is again becoming more competitive in export prices, while holding slots for products that are in short supply and a quasi-monopoly, such as mid-range semiconductors. These are items that cannot be replaced in the short term by other producers.

Together, **these examples show how hard it is to distinguish short-term events from long-term trends in China's economy.** For foreign trade, what is the overall trend? Is it back to the decade-long reduction of the trade surplus relative to GDP before the pandemic? Or to a renewal of its rise since 2020? For energy consumption and demand to the outside world, China's potential for coal use remains huge, and a decision to turn up or down coal mining and use makes a huge difference for the energy mix and CO_2 emissions. The judgment on China's will and capacity for a transition in its economic model – from mercantilist, high investment and energy intensive to consumption, services and lower emission model – highly depends on one's time frame. It is also clear that China has increasingly backtracked from its reforms after 2012 due to their unintended effects.[5] Or perhaps, Xi Jinping, the man with a combination of practical opportunism and an iron will, has always drawn the line at changes that challenge the party state's supremacy, including over the economy. Doing away with external capital controls, massive liquidity creation, continuing the reform of state enterprises may never have been seriously considered. The limits to marketization and private enterprises was always there.

5 Daniel H. Rosen, "China's Economic Reckoning", *Foreign Affairs*, July/August, 2021, https://www.foreignaffairs.com/articles/china/2021-06-22/chinas-economic-reckoning

Of course, the 2022 lockdowns are the main causes of this spring's economic fall. They have been brought on by a combination of the more contagious Omicron variant and by China's official insistence on Zero-Covid policies. Lockdowns have now receded in the country at large, including in Shanghai and Beijing which were at the center of attention. This is especially true for Shanghai, crucial to important export industries (IT and auto) and to logistics. Because Omicron and its recent variants are highly contagious, many observers assumed that **China's Zero-Covid policies could not hold and that China would enter an era of perpetual lockdowns.** The spring 2022 wave of lockdowns in China indeed have a longer impact on the economy than the initial 2020 pandemic. There is clearly a probability of recurring Covid infections. But the Party state has used a modern version of its 1950s successful mass campaigns to swat flies, and it is working, at the cost of large human pressure and economic losses. "Dynamic Zero-Covid" policies are now both routine and more fine-grained.

II

THE EXOGENOUS PANDEMIC SHOCK IS LIKELY TO LEAVE LESS OF A TRACE THAN ENDOGENOUS DEFICIENCIES

In any case, the pandemic also remains an exogenous shock to the economy. But is this impact going to be a permanent feature? **The history of epidemics shows that they have sharp but time limited-effects** – unlike structural economic problems. In due course, the pandemics are even more likely to be forgotten. On the other hand, endogenous factors – low and declining return on capital, declining demography and labor force, rise in total debt and a forced ending to the real estate based growth, are likely to prove much more enduring.

The two trends – one on the export seesaw, the other on the surging and receding Covid waves – put in sharp relief several dangers in China-watching: one is **mistaking short-term and exogenous events for endogenous and structural crises bringing long-term changes – or need for changes – in the economy.** The other one being the misperception deriving from the contemporary news cycle: **it amplifies bad news over good ones.** This does compensate for China's official propaganda bias towards rosy news. Even with a domestic Chinese audience that is saturated with positive propaganda, and of course among foreign residents of China, skepticism is rife and rumors abound.

There has also been a confirmation bias for many economists invested into China's interrelation with the global economy. They – and their liberal disciples in China who often took cues from the World Bank and their alma maters in the United States – have long argued **the need for massive structural change in China's political economy.** There is a lot of truth to this, as China reaches the lower threshold of a developed economy with a 12,000 USD per capita GDP – even if only 44% of that goes to household income, as opposed to 60-80% for more conventional developed economies.

From this credo and advocacy, they deduce easily that events are going to force a reformist outcome, and/or that it is likely to be decided by "rational" leaders sharing the same perception of the country's best long-term interest. The latest example of this has been a recent flurry of quick takes, from unofficially reported extracts of a speech[6] by Prime Minister Li Keqiang at a 10,000 cadre meeting on May 25. Likely authentic, the transcript from a recording has nonetheless been taken off the Chinese web. Major addresses by leaders to a closed audience are never published without delay and without redacting. **An interpretation made the rounds that Li, a few months away from his retirement, was taking a stand against Xi Jinping and focusing his opposition on economic policy.** A comparison was even made with the famous January 1962 "7,000 meeting" signaling the failure of the Great Leap. Former president Liu Shaoqi then famously blamed that failure on "70% human mistakes" – e.g. on Mao. Such a takeaway is misleading. At best, a comparison could be made with former prime minister Wen Jiabao's words in favor of democratization in the last months of his tenure in 2012. Li's May speech has none of these traits.

6 Stock market scattered 9, "Biography: Recording of a speech on stabilizing the economy (传: 稳经济大盘讲话录音)", *Longbridge app*, May 25, 2022, http://archive.today/85Qed

III

POLICY CORRECTIONS HAPPEN UNDER THE OVERALL AUTHORITY OF XI JINPING

In reality, the speech attributed to Li Keqiang is a careful description and justification for the new "stabilization" 33 stimulus measures launched in the same month. He praises the orthodox monetary and credit policies of the past two years – while clearly indicating where the gates must open more. He fleetingly mentions a proposal to distribute income to all households, only to reject it. Li is fulfilling his prime minister role with a hands-on approach that mentions the local visits he has made. Perhaps, the most striking note in his speech is the insistence on the resumption of production – in two cases, even if there are local epidemic outbreaks. For agricultural crop harvesting, this is in the name of food security: "even if an epidemic arises at harvesting time, no matter what, harvesting must go on". Solving the logistics jam at China's borders is the other exception to complete lockdown policies that Prime Minister Li Keqiang has mentioned in his May 25 speech.[7] His justification is that custom receipts are the first source of central budget income: as such, they are essential to national security and defense. In these two cases, **the implied exceptions to Zero-Covid policies are justified by Xi Jinping's other key priority – national security including food supply and defense.**

Xi Jinping has done away with collective leadership, Yet he does share the limelight with other leaders when he needs to deflect potential criticism against himself. That was the case in early 2020, when after two months of denial, the Party-state embarked on a rigorous Covid containment policy: a video showed the Politburo in debate about Covid, implying that the decisions were collective. Other leaders were then selected for difficult visits to ground zero in Wuhan. At the end of 2020 Xi Jinping decided to take full credit for the success of what became known as a Zero-Covid policy. Chinese state medias then attributed the success of the flight against Covid to Xi Jinping, who was "at the core of the Party Central Committee's coordination and

7 Bai Yu, Zhao Xinyue, "Li Keqiang emphasized at the national teleconference on stabilizing the economy, that the implementation of various policies to stabilize the economy will be effective, that market entities will ensure employment and people's livelihood, and that the economy will operate within a reasonable range. Han Zheng presided over (李克强在全国稳住经济大盘电视电话会议上强调 扎实推动稳经济各项政策落地见效 保市场主体保就业保民生 确保经济运行在合理区间 韩正主持)", *People's Politics*, May 25, 2022, https://archive.ph/ky7lQ

leadership" (以习近平同志为核心的党中央统揽全局、运筹帷幄).[8] Such is again the case now. **Policy corrections are happening under the overall authority of Xi Jinping, but their announcement and fine-tuning is presented by the government.**

8 Liu Chang, "Breaking the wind and breaking the waves to open a new situation - a commentary on the high-quality development of China's economy in 2020 led by the Party Central Committee with Comrade Xi Jinping at its core, (逆风破浪开新局——以习近平同志为核心的党中央引领2020年中国经济高质量发展评述)", *China Government Network*, December 15, 2020. http://archive.today/BZDth

IV

REGAINING TWO OF THE THREE ENGINES OF CHINA'S ECONOMIC GROWTH

China has just gone through a sharp economic downturn, particularly pronounced for some sectors of the economy and society: household consumption, services including, of course, travel and catering, small and medium companies, employment and singularly youth employment. **As Chinese economists often say, there are three main engines to China's hypergrowth: investment,** especially into new infrastructures and formerly also into real estate; **exports,** including by foreign firms although their share has steadily declined; **and consumption and services.** Underlying the first two engines, a mammoth savings rate by both households (which are penalized by low returns on savings and capital controls) and corporate gains (especially SOEs which retain a large percentage of their profits) are key financing sources.

The budgetary orthodoxy of the central government, and the proceeds from trade and external account surpluses that must be converted into foreign currency reserves to avoid a massive reevaluation of the yuan are important. They provide a cushion against contingencies. However, ever since 1995 and a centralizing reform of taxation, **it has been local public budgets that have been getting chronically unbalanced and generating overt or covert debt.** Part of the so-called corporate debt is in fact local public debt in disguise, either through "shadow banking" or forced investment decisions. In part, Xi's restraint on budget, credit and monetary policies is a bulwark against runaway trends at the provincial level.

The long-term trends, including the rise of corporate debt, the lending allowing for the world's largest real estate boom, and a turn by households to borrowing, have changed the picture on savings. But we shall deal later with these long-term trends, and focus for a moment on the short-term changes in 2022. **The harsh lockdowns of this spring have simultaneously killed two of China's three growth engines: household consumption & services, and exports.** Investment, especially into infrastructures, is the engine that pulls through the economy. Even with this remaining engine, there is one big reservation: so many roads, rail lines, ports, airports, cities, energy plants and model cities have been built that they barely leave room for more. More stimulus produces more GDP, but at the cost of "bridges to nowhere", or useless construction, much as in the Japan of the 1990s. As things stand in mid-2022, this is very much the route taken to produce a quick GDP rebound, and perhaps a favorable environment for the CCP 20th congress in the fall.

True, there is also a growing emphasis on **investment for R&D and innovation** generally, and for the digital and energy transitions. In the new stimulus plan, modernist technocrats have had their say more than at any previous time. They advocate targeted support towards all sorts of transformational goals and projects, from innovation to environmental goals. They also have sought to support more directly small and medium firms, including micro or individual enterprises: the recent Shanghai stimulus plan, very detailed, gives multiple examples. For instance, it includes subsidies for land use and delays for debt repayment (but not forgiveness).

But in the short term, this does not lift as much the overall economy or contribute to GDP as good old-fashioned projects.The bulk of the stimulus still goes to traditional investment projects. Here comes the Chinese government's in-built preferences, as well as Xi Jinping's own touch, which has only added to existing biases. Large-scale, centrally managed projects, "key" industries well represented by SOEs have constituencies both at the central and local levels. **This traditional direction of investment, and the newer approach towards innovation, small firms and even issues such as unemployment focus on the supply side, while almost nothing goes to the demand side of the economy.** Even tax or social security or land use rebates target companies, not households. The young are helped via measures for education and employment, not with unemployment compensation or subsidized income.

As to Xi Jinping, his recurring harsh words against the "laziness" induced by Western welfare states, and the campaign started under him against new "lying flat" trends in society (doing the bare minimum to get by) reinforce the bias against direct subsidies to individual income. Perhaps the only trace of this type of direct support lies in some consumption vouchers. Even in this area, **stimulus plans give more attention to launching consumption "fairs", and other public encouragement to consumption, but not to funding consumers.** "Helicopter money", as it has been called in other places and practiced by the Biden administration or in France with subsidies to cap energy prices, remains a no-go area in China. Consumption vouchers, ritually mentioned by some Chinese economists in the past two years, are out.

Thus, **China's central economic policy remains Marxist – based on expanding the forces of production –** and quasi-Friedmanesque:[9] rejecting Keynesian pump priming or a welfare state. Massive liquidity creation, beyond incremental steps, or buyback of bonds by the central bank are out. Burgeoning new debt is pushed out to local governments and state firms.

Instead, for the past two years, most economic debates have focused on other issues: whether and how far to indulge into a looser monetary policy (lowering interest rates and reserve requirements, encouraging credit and total social financing), and how to direct these stimuli to the investment side. The answer until April 2022 was restrained. The changes were to be gradual and even incremental, although the state moved from a 2021 policy of only matching the credit expansion with the GDP growth rate (for China, an extremely restrictive policy) towards a policy of more dynamic support. Some measures were by sleight of hand: for example, keeping the same quotas for subsidies to infrastructures or credit but moving them forward to the first part of the year. **Throughout this period, geopolitical priorities prevailed, with the need to avoid any more financial vulnerability to the outside world, and to "guard against black swans or gray rhinos".** As China's Politburo put it again on April 30:[10] these potential surprises are often depicted as the consequences of a direct confrontation with the US.

9 François Godement, "Xi Jinping As An Ordoliberal: China's Margins For Growth In 2022", Institut Montaigne, February, 2022, https://www.institutmontaigne.org/en/publications/xi-jinping-ordoliberal-chinas-margins-growth-2022

10 Ren Yilin, He Jingru, "Learn from time to time: The epidemic must be prevented, the economy must be stabilized, and development must be safe. The meeting of the Political Bureau of the Central Committee deploys the current work. (時習之疫情要防住 經濟要穩住 發展要安全 中央政治局會議部署當前工作)", *People's Daily Online* – Chinese Communist Party News Network, April 30, 2022, http://archive.today/GUdso

V

THE GROWING RISK OF A BALANCE SHEET RECESSION

Supply-side policies haven't delivered much result so far for several reasons.

One is that cuts in interest rates and in reserve requirements, or easing of credit quotas, have certainly benefited the banking system – and their large corporate debtors, for instance in the real estate sector. This does create a moral hazard – and we are currently witnessing a rash of runs on small local banks that have gone over their heels into lending to corporate clients and proxies for local governments. But the funds are hardly filtering to the real economy. Li Keqiang complains about retention of funds by the banks.

The second reason is that recurring and unpredictable lockdowns have made customers shy of spending – obviously on travel and catering, but also on big ticket issues such as cars and housing. **"The lack of demand is the key contradiction of the Chinese economy"** as one economist puts it.[11] Or as the French proverb goes, *"on ne saurait faire boire un âne qui n'a pas soif":* you can't force a donkey to drink if it is not thirsty. In fact, the Chinese have essentially used their extra savings since the 2020 pandemic to deleverage their debts. One might add that the real estate financial crisis also forces companies to try and reduce their exposure, and that local governments now lack part of their fiscal resources that came from land sale auctions.[12] Thus, deleveraging old debt slows down consumption and therefore income and tax returns – again creating the need for new debt. In 2020, while the gross savings rate increased by a full 1% GDP point, total indebtedness shot up from 247 to 270% of the yearly GDP. Today, deleveraging is made even more difficult by the burst of the real estate bubble.

11 Global Think Tank CCG, "Xu Hongcai: The National Standing Committee launched a "package" of measures to stabilize the economy (徐洪才：国常会推出"一揽子"措施稳经济)", June 6, 2022, http://archive.today/GBun2
12 Philippe Aguignier, "Financial Instability in China: A Real Estate Crisis Long in the Making", Institut Montaigne, June 15, 2022, https://www.institutmontaigne.org/en/blog/financial-instability-china-real-estate-crisis-long-makin

Little mentioned outside China, a third factor has come into play: an almost non-existent inflation, helped until March 2022 by the rise of the yuan that cut import prices. **While the rest of the world struggles with inflation, China has been hovering around a 1% inflation rate** (only reaching 2% for food in April 2022). As mentioned above, the renewed predominance of domestic coal in the energy mix also means that China has been spared much of the international energy price rises.

This is not as good as it sounds for the domestic economy. First, Chinese economists consistently cite the US Fed interest rise, which has been caused by inflation abroad, as the first risk to China's economy: a large interest rate differential between the US and China ensured inward capital flows to take advantage of it, and discouraged capital flight by domestic holders. Second, economic actors, and especially domestic consumers, now anticipate both economic risks – lockdowns or Ukraine related – and no inflation. The former discourages them from consuming, the latter also means there is no need to anticipate price rises. It is what the Nomura economist Richard Koo (Koo Chaoming) , now cited in China,[13] has termed **a "balance sheet recession",** from the experience of Japan's "lost decade" of the 1990s. Massive liquidity creation then went to precautionary savings and debt repayments but not to business investment or household consumption. In this situation, **no amount of monetary or credit stimulus could restart fast growth.** The condition is different from the stagflation now threatening European economies, but it is nonetheless worrying.

13 Zhu He, "Four questions to ask about a 'balance sheet recession' (关于"资产负债表衰退", 四个问题需要厘清)", *China Finance 40 Forum*, June 6, 2022, http://archive.today/4Tqll

VI

THE FISCAL GAP, CHINA'S NEW DEBTS AND MONETARY IMPLICATIONS

China is still far from the level of monetary creation that Japan reached during its long semi-stagnation. Yet the level of indebtedness, already high and further increased by the real estate crash and the recent consumption downturn, has created a sudden fiscal gap. **Although the government does not sprinkle money, it does grant tax rebates to companies.** In April, YoY fiscal receipts declined by 4.9% YoY – but by 41% if one includes tax rebates. Other rebates decided in May – postponement of social security and unemployment payments by companies –, and the cost of repetitive mass Covid testing are likely to increase the gap. PM Li Keqiang estimates the total values of tax and social rebates at 3 trillion yuan in 2022 – nearly 3% of GDP. Many of these measures are likely to be borne directly by local governments, which also suffer from continuously poor land sales.

Thus, in spite of the formal adherence to the orthodox monetary and credit prescriptions that have been hammered over time by Xi Jinping in the name of geopolitical security, the massive rebates in government collection of taxes and social security contributions amount to a loosening in disguise. **Formally, public expenditures are still restrained, but the fiscal gap creates automatic new debt at the local government level and also frees resources for companies.**

Several economists, whether they cite or not Richard Koo's conclusion on the Japan of the 1990s, point out that **a large fiscal gap and the resulting increase in debt are only viable with "an accommodative monetary policy".** Huang Yiping, a well recognised Chinese economist from Peking University, cites European Central Bank (ECB) Mario Draghi's "whatever it takes" of July 2012 that turned around the Eurocrisis.[14] But Huang also outlines consequences for China. He cites first the famous Mundell triangle (one cannot have simultaneously free capital mobility, fixed exchange rates and independent monetary policy), and goes on to Hélène Rey's

14 Liang Bin, "Huang Yiping: Adhere to the monetary policy based on the total amount, and be cautious about the structural monetary policy, (黄益平：坚持总量为主的货币政策, 谨慎对待结构性货币政策)", *Finance Sina*, June 13, 2022, http://archive.today/Lv4m9

reduction[15] of Mundell's trilemma to a dilemma: an independent and accommodative monetary policy requires strong capital controls. Indeed, as Hélène Rey explains, a fixed exchange rate with the world's capital center, the United States, transfers pressures from US interest rates to the other economies. His colleague Zhang Bin stays with Mundell and therefore lays out another path: a market-based exchange rate mechanism that spontaneously defuses pressures on capital flows.[16] Thus, **two well-known economists often cited together actually suggest very different policy paths.**

15 Hélène Rey, "Dilemma not trilemma: The global finance cycle and monetary policy indepenedence", *NBER Working Paper Series*, February, 2018, https://www.nber.org/system/files/working_papers/w21162/w21162.pdf

16 CF40 Research Department,"The Shanghai Stock Exchange "falls" 3,000 points, and the policy to stabilize growth needs to be implemented urgently, (沪指"失守"3000点，更大力度稳增长政策亟待落地)", *China Finance Forum*, April 25, 2022, https://archive.ph/KfoMk

CONCLUSION

STABILITY OVER GROWTH REMAINS XI'S KEY CHOICE

The above debate remains ahead of the government's curve, which is to tilt China's economic policy towards additional and more targeted support for growth without changing the basic precepts: "stability", flexible but managed exchange rate and limited use of the monetary tool. Ever since China's successful 2015 bid to make the RMB an IMF's reserve currency, it has pulled back on the liberalization of capital flows. Instead, **it has practiced a cautious "flexible" monetary policy steered by the central bank.**

But we now live in interesting times. Japan, hit by a stagflation risk, is literally following Richard Koo's prescription: the Japanese yen is down by 24% to the USD (as of June 15) from the end of 2020, while the renminbi on the same date has merely gone back to its end of 2020 level. The two economies are very integrated (378 billion USD in bilateral trade) and increasingly competing over the same export slots. In addition to the arguments above, **Japan's currency developments are likely to influence China's own monetary developments in the near future.** While China's Huang Yiping endorses a conservative government policy of capital control to allow for a much more accommodative monetary policy that promotes growth, Zhang Bin advocates a break with managed or "flexible" exchange rate policy. This advice is closer to two decades of liberal advocacy in China on the same issue. But Japan's sharp currency fall gives it more saliency.

Needless to say, the two paths have their own dangers. In such a context of industry, trade and monetary integration with the rest of the world, capital controls are not airtight. They may also further discourage **inward capital flows.** A **free exchange rate,** theoretically a condition for a future healthy capital market, can in the short-term produce a run on the currency by domestic actors.

The first Xi decade has seen economic risks mount in spite of cautious central budget, credit and monetary management. There has been a capital and labor productivity decline, growing and spreading indebtedness, more political

control prevailing over several innovative sectors, a less welcoming international environment for China's outward investments and trade surpluses, and a sudden and sharp demographic decline. A familiar perspective is therefore returning, that of necessary choices for a China that is once again "at the crossroads".[17]

Xi's preference for a concert of autocracies against democracy, the risks constantly outlined from a loss of control by the CCP over the economy and society, and the political uncertainties currently faced by market democracies make a return to reform and major systemic change very unlikely. China is now reaching for the best of innovation, fostering every measure possible to be number one in green technology, beginning support to a complementary but not challenging sector of micro-enterprises. But **it will not break with the basic tenets of the Party state's political economy.**

17 François Godement, "China at the crossroads: are the reformers winning the argument?", *European Council on Foreign Relations*, April 5, 2012, https://ecfr.eu/publication/china_at_the_crossroads_are_the_reformers_winning_the_argument/

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THERE IS NO DESIRE MORE NATURAL THAN THE DESIRE FOR KNOWLEDGE

China's Change of Economic Model: Not So Fast!

Following this spring's deep economic downturn, **China's export bonanza that earlier amplified with the pandemic has now resumed.** As the country shifts back to a domestic low-cost energy mix based on coal, its oil and LNG imports are down on a year to year although China follows India in May by upping its supply from Russia. These contrasting developments – a partial recovery after several months of downturn, itself following a successful economic path through two years of pandemic – shows how hard it is to distinguish short term and long term in China.

Beyond the impact from an exogenic shock – the pandemic – there are long-term endogenous deficiencies. China has moved towards **a policy of more dynamic support,** based on support for companies and key sectors, especially infrastructures, and also targeted at small firms, innovation and youth unemployment. However, **China's central economic policy remains Marxist** – based on expanding the forces of production. With most stimulus going to the supply side of the economy, and not to the demand side, China faces the growing risk of a balance sheet recession, where low expectations curtail consumption and create a fiscal debt – and more debt.

Overall, **a return to reform and major systemic change is very unlikely under Xi.** Policy corrections are happening, but China won't change its basic precepts and stability remains prioritized over growth.

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