



# China's Economic Rebound: Views from Beijing



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# China's Economic Rebound: **Views from Beijing**

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*There is no desire more natural  
than the desire for knowledge*

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# INTRODUCTION

**China's macroeconomic policies**, including the implications of **decarbonation pledges** and the recent **demographic findings**, have been the subject of much public debate in China in recent months. It is a rare enough occurrence in today's China to merit a closer look.

Among the movers of these debates, one finds members of the Monetary Policy Committee (People's Bank of China's advisory body), influential figures (notably Long Yongtu, former Chief Negotiator of China's WTO accession, or Zhou Xiaochuan, former Governor of the People's Bank of China). Even People's Bank of China officials have joined the fray with varying suggestions for China's link to the US dollar. Some views and proposals are also expressed by members of economic associations, with input by analysts from the private financial sector. They are often found on the China Finance 40 Forum (CF40) website,<sup>1</sup> which also serves as an outlet for the views of "young economists".

**These views combine analyses of the international economy** – often through the lens of US policies (as discussed below) – **with an examination of the Chinese economy and its fiscal and monetary policies, in relation with the US angle**. This approach diverges from strict official announcements and statements, which usually ignore international comparisons and focus solely on China's achievements: Xi Jinping himself has sometimes referred to the international situation, calling it a "once in a hundred year opportunity". Other times, he has merely emphasized uncertainty. **The other economies – Japan, ASEAN, Europe and the rest of the world – occupy a very secondary position in these examinations**, no doubt because their public decisions are not considered to have as much influence on the Chinese economy.

The following policy note aims to cover these views and debates from China – and therefore does not include international sources. It should also be emphasized that **the views presented here are not this writer's, even if some comments are included**. Several key aspects that international experts would likely have mentioned are not present: the Belt and Road Initiative (BRI), its cost and economic implications; China's defense and domestic security spending; the cost of its support for innovation and industrial policies in key areas; China's international investment strategy beyond broad FDI figures. There are probably good reasons for that. The BRI is a signature initiative of Xi Jinping, and off-limits to critics, even though it has been rationalized since 2019. Industry and innovation plans can be described in detail,

<sup>1</sup> China Finance 40 Forum, 中国金融四十人论坛, <http://new.cf40.org.cn/>

but not in relation to their overall cost or opportunity. Military and security spending is even more of a sensitive subject.

Instead, the note covers what is available in Chinese macroeconomic debates, to which decarbonation policies are often annexed. The recent publication of some results from the 2020 demographic census is also sparking some responses.

The four parts of this policy note cover:

- 1) **The economic rebound from 2020**, preferably with a 2019 baseline. Most numbers are based on Q1 2021. The changing contribution to this rebound from different components (exports, infrastructure investment, real estate, industry and services, household consumption).
- 2) A 2021 debate on the continuation or tapering off of **support measures to the economy**. Their direction – to the supply side or towards increasing demand – is a key topic. Assessment of public and private debt, and choices to be made between the fiscal leverage (credit) used so far, and a monetary policy providing liquidity to the economy.
- 3) **Decarbonation** has little or no place in the macroeconomic analyses that we have seen so far. However, it is in itself a subject of economic debate, no doubt linked to **China's energy production and consumption trends** in 2019-2021. Decarbonation is also a driver of international engagement with the Chinese leadership.
- 4) To these themes, one can add **a new debate on demography** and the economy, following the surprising results of the 2020 census and a significant drop in birth rate.

**The most common element dominating these different perspectives is uncertainty**, at different levels:

- The trend for the pandemic may positively or negatively affect global demand for Chinese goods. **The main variable is the resumption (or not) of full production in other developed economies** and its effect on this demand and, therefore, on Chinese exports. The hypothesis of a pandemic affecting China again – or the fear of such a prospect affecting the behavior of economic actors – is never mentioned.
- The international context, and in particular **the hypothesis of a subsequent tightening of US monetary policy after its two large stimulus plans**. Chinese

analysts often refer to the case of the 2008-2014 cycle after the global financial crisis. This started with an unprecedented quantitative easing that benefited the Chinese economy. It ended, however, with monetary tightening and a rise in the Federal Reserve Bank's interest rates. These led to a flight of Chinese capital and a fall in the local stock market.

- The **risk of imported inflation** due to the synchronization of stimulus plans in developed countries is constantly mentioned – but more as a risk than as a certainty.
- The **risk of further increased domestic debt** due to China's fiscal and credit policy, with the control over public credit potentially leading to transmission of new debt to households, particularly in real estate.
- The **possibility – seen as a risk – of a carbon adjustment tax at the border** that would be implemented by other industrialized countries, is often cited as a factor in speeding up China's decarbonation policies.

In addition to these uncertainties, there is **widespread indecision regarding the Chinese government's own economic strategy**. It is true that Chinese analyses do not point to the massive levels of support for supply and state-owned businesses, which is usually mentioned first by foreign observers. Nor do they touch on the massive public programs to support R&D, innovation in general, and digital industries in particular, or even military-civil fusion. Only the poverty alleviation policy, which concerns the poorest 5% of the population, is systematically mentioned. The idea and success of poverty alleviation are directly attributed to President Xi. The broader economic implications of these programs are seldom discussed.

Sectoral policies are mentioned from a general angle – that of the **necessary evolution from “all-out” support for supply to a so-called “precise drip irrigation (精准滴灌)”<sup>2</sup> strategy** – allowing targeted, more discriminating, and, above all, more limited in volume. This more targeted approach should be put in relation with China's “national development strategy driven by innovation” and the move to future self-reliance implied by the concept of “dual circulation” which was prominently displayed in 2020.<sup>3</sup> The topic of better credit targeting comes up often, and understandably so: for decades, China's credit policies, marked by alternating expansion and tightening,

<sup>2</sup> Zhang Lianqi, “Active fiscal policy should be multi-pronged to keep the economy running in a reasonable range (积极财政政策要多管齐下 保持经济运行在合理区间)”, Center for China and Globalization (中国与全球化智库), April 12, 2021, <https://mp.weixin.qq.com/s/mXyA5bM0kh6XNLOBfsnbfQ>

<sup>3</sup> Viviana Zhu, China Trends N° 7, *China's Dual Circulation Economy*, October 26, 2020, <https://www.institutmontaigne.org/ressources/pdfs/publications/china-trends-7-EN.pdf>

have not known how to identify actors or the quality of borrowers adequately. Hence, these policies have consisted of general targets and quotas for the entire banking system. For a long time, Chinese state companies exchanged their debt quotas: what was set as an upper limit to their debt thereby became an average shared by most companies...

As we shall see, this climate of uncertainty, highlighted by most analyses, is also reflected in China's official statements on the international and Chinese economies in 2021.

Yet, even if unevenly distributed across sectors and affected by a very low starting point in 2020 – and by an ex-post downward revision of the 2019 GDP! – **the Q1 2021 economic recovery has extended the recovery of the second half of 2020 for exports and real estate, including construction.** The picture is more uneven for consumption, with a spike in March: is this sustainable, or is it a spike, ask China's economists? The April numbers point out more to a repeat of the 2020 model than to an accelerating shift towards a consumption-led economic growth.

## WHAT THE NUMBERS SAY

Overall, **comparing China's growth to those of other countries is to China's advantage.** It is worth noting that analysts compare the Chinese forecasts to those of OECD countries rather than other emerging or developing economies. This, of course, does not follow the official doctrine that China remains a developing economy.

### 2021-2022 Economic Growth Forecasts by International Organizations<sup>4</sup> (in %)

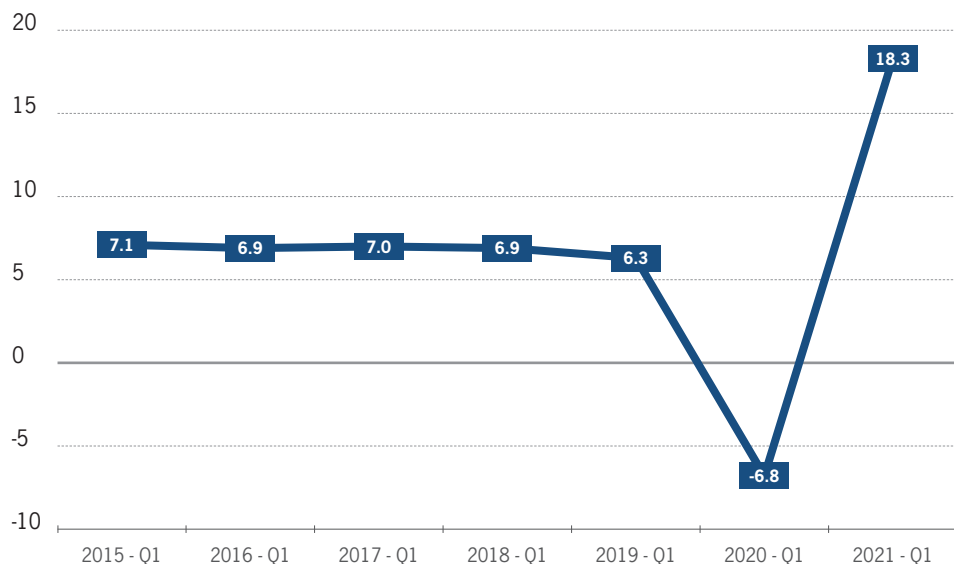
		World	United States	China	Eurozone	Japan
OECD estimate in March 2021	2021	5.6	6.5	7.8	3.9	2.7
	2022	4	4	4.9	3.8	1.8
World Bank estimate as of January 6, 2021	2020	-4.3	-3.6	2	-7.4	-5.3
	2021	4	3.5	7.9	3.6	2.5
	2022	3.8	3.3	5.2	4	2.3
IMF estimate as of January 26, 2021	2020	-3.5	-3.4	2.3	-7.2	-5.1
	2021	5.5	5.1	8.1	4.2	3.1
	2022	4.2	2.5	5.6	3.6	2.4

Source: Translated version, Zhang Yansheng, "In 2021, danger and opportunity coexist (2021年, 危和机同生并存)", April 14, 2021, *The Paper*, [http://www.thepaper.cn/newsDetail\\_forward\\_12184680](http://www.thepaper.cn/newsDetail_forward_12184680)

For Q1 2021 results, growth is +18.3% year on year (YoY), from the very low base of Q1 2020 (-6.8%). The picture painted by analysts suggests **a stronger recovery in supply than in demand, and in housing and construction than in manufacturing or even in infrastructure. It also suggests a widening gap between coastal and inland regions and between the north and south of the country.**

<sup>4</sup> Data and predictions may have changed since this source assembled the table.

**China GDP Growth Rate**  
(Q1 YoY, 2015-2021)



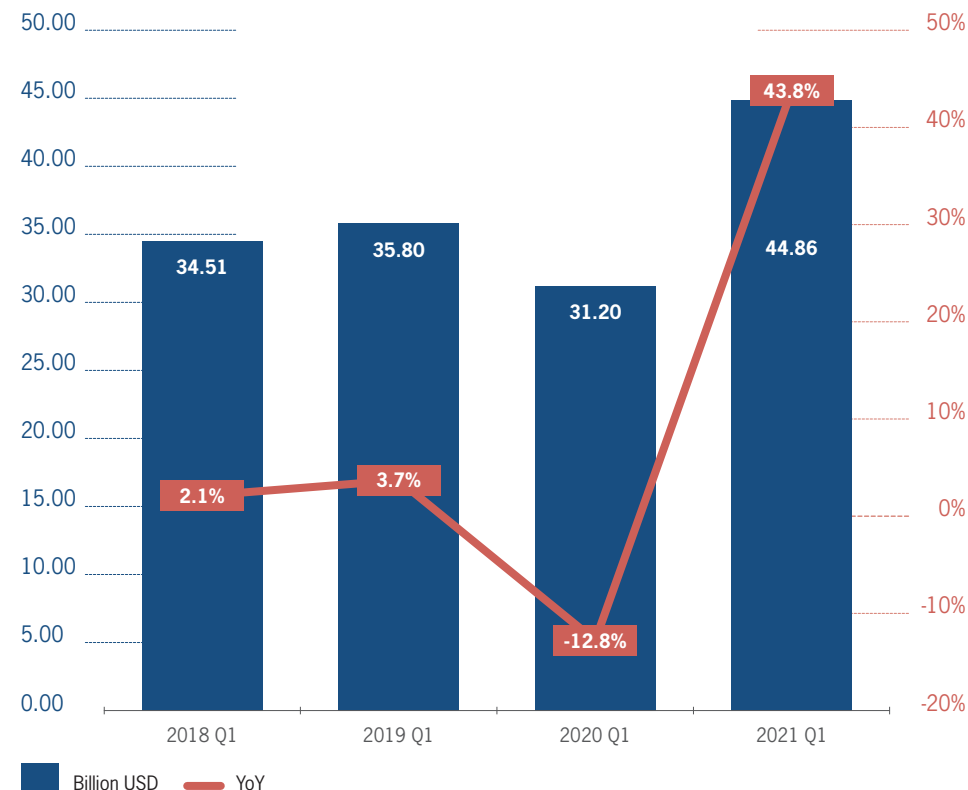
Source: Statistics published on the website of the National Bureau of Statistics of China.

China's direct investment abroad picked up somewhat in the past year (in Q1 2021, +4.6% YoY in CNY terms, +12.6% in USD terms): the trend is less positive towards the 52 Silk Road countries (-2.2% in CNY terms, +5.2% in USD terms). By contrast, both FDI coming to China and financial inflows have seen a huge growth in 2020, up to and including the first quarter of 2021. According to UNCTAD figures, **in a global context of declining direct investment, China has become the world's leading destination in 2020**, ahead of the United States: 77% of these investments are going to services, which may indicate a positive expectation regarding the future expansion of this sector.<sup>5</sup> In Q1 2021, **foreign investment in China continued to break records** (+43.8% in USD terms, i.e., close to USD 45 billion). The *People's Daily* calls this "a vote of confidence by international capital".<sup>6</sup>

<sup>5</sup> United Nations Conference on Trade and Development (UNCTAD), "Global Investment Trend Monitor No.38", January 24, 2021, <https://unctad.org/webflyer/global-investment-trend-monitor-no-38>

<sup>6</sup> "Why China can become the Promised Land for investment (人民财评:中国为什么能成为外资"应许之地"?)", *People's Daily*, May 16, 2021, <https://finance.sina.com.cn/tech/2021-05-16/doc-ikmyaawc5628145.shtml>, cited by Mathieu Duchâtel in "Supply Chain Security: from Taipei to Brussels", Institut Montaigne, May 18, 2021, <https://www.institutmontaigne.org/en/blog/supply-chain-security-taipei-brussels>

**Foreign Direct Investment (FDI) in China**  
(Q1 YoY, 2018 - 2021)



Source: Statistics published on the website of the Ministry of Commerce of China.

Financial capital also flowed into China in 2020, **driven both by positive interest rates (the only ones among major industrialized countries) and by the quick containment of the Covid-19 pandemic**, heralding an economic recovery ahead of other economies. It is apparent that foreign finance and insurance companies have mostly not bought into any decoupling strategy.<sup>7</sup> For the remainder of 2021, some Chinese analysts speculate that the return of positive interest rates in developed economies and the recovery that has begun in the US could reduce the inflow of financial capital to China. This would also reduce the pressure to revalue the renminbi.

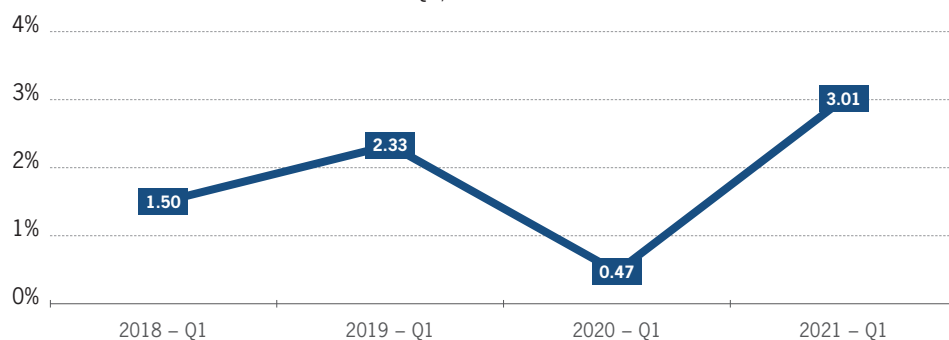
<sup>7</sup> James Kynge, "US-China investment flows belie geopolitical tensions", *Financial Times*, February 4, 2021, <https://www.ft.com/content/b3dcc262-a153-4624-bc1d-156179d6e914>

Nothing matches the performance of Chinese exports: they reached **historic heights in 2020 with a trade surplus of USD 535 billion** and are expected to reach approximately USD 300 billion in 2021. One number, for an item much in the news in 2020, symbolizes the flexibility of China's industry: during that year, China exported 270 billion personal protection masks – or nearly 42 masks per human being outside China.

In Q1 2021, the trend remains explosive: the trade surplus reached USD 116 billion. At the end of 2018, there were international expectations that a diminishing trade surplus and higher capital outflows would put China's current account balance into the red. That trend has not materialized so far. In fact, the post-pandemic rebound of exports results in a 3% trade surplus to GDP ratio for Q1 2021.<sup>8</sup> However, March 2021 saw a strong rebound in imports, breaking with the trend seen over the past year, which requires further analysis. In March, imports rose 38.1% YoY and 16.7% over two years, while exports grew 30.6% YoY and 10.3% over two years. **For the first time, foreign demand for medical and digital products as well as home appliances slowed.** This last trend is directly linked by analysts to the reduced impact of direct distributions to households on US consumption, with only 25% of the third USD 2,000 stimulus check going towards consumption rather than savings. Overall, both imports and exports are growing faster with commodity and energy-producing countries (X 9.8%, I 18.2%) and with the European Union (X 5.1%, I 11.8%) than with the US (X 2.5%, I 10.5%). **Therefore, the trade surplus with the EU is also growing faster than the trade surplus with the United States.**

### China Trade Balance / GDP Ratio

(Q1, 2018-2021)

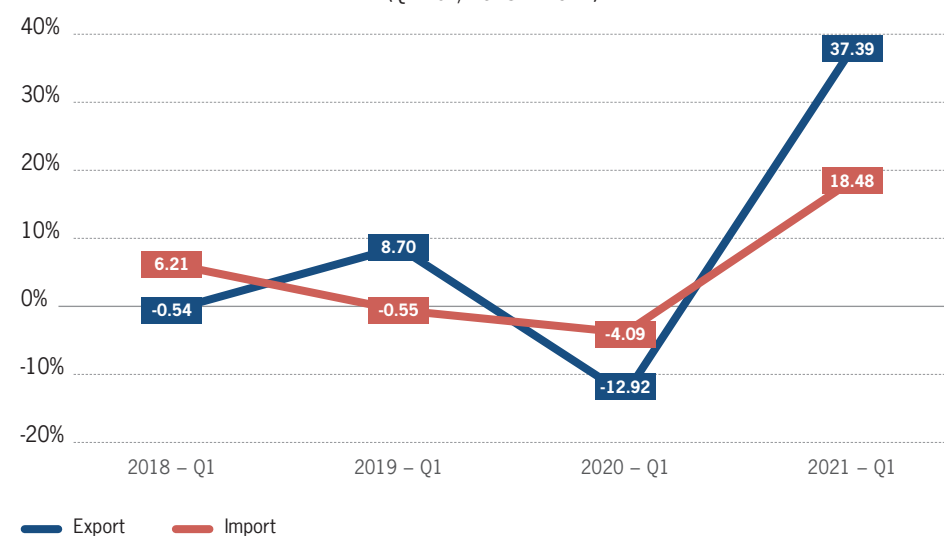


Source: Statistics published on the website of the General Administration of Customs of China.

<sup>8</sup> All the figures we refer to come from the PRC's General Administration of Customs: <http://english.customs.gov.cn/Statistics/Statistics?ColumnId=7> (except for the 2021 trade surplus forecast).

### China Manufacturing Goods, Import and Export<sup>9</sup>

(Q1 YoY, 2018 - 2021)



Source: Statistics published on the website of the General Administration of Customs of China.

Still, much of this increase in imports is due to commodities and energy (except coal), both in volume and in value: the record is held by iron ore, for which imports increase in value by 112.5% YoY, followed by soybeans (+41.5%). The trend for imports of electromechanical products, semiconductors, and, more broadly, high-tech products is declining slightly, although the increase in absolute value (+26.1% and +24.4%) remains very significant. **These figures can probably be linked to Chinese fears of a global rise of inflation as well as expected political difficulties, leading to preemptive purchases of primary products and the stockpiling of IT components.** Fearing global inflation, China is also becoming one of its causes.

Behind these overall figures and a dynamic foreign trade picture, **other aspects of the economy appear much more sluggish – or stable**, depending on the case study. While value-added in large manufacturing industries is emerging on a two-year on year basis at +8.4% in March, sales of consumer goods grew by only 3.2% over the same period, and fixed investment by 1.7%. In April, early trends – including the PMI – pointed to a possible slowdown in growth, while demand for steel, ore imports and PPI continues to rise: a sign **that construction is still driving growth.**

<sup>9</sup> At USD exchange rate for March of each year, applied to original CNY data.



These contrasting trends are related to the **gradual reduction in public support for the economy, both in the central budget and in credit operations.**<sup>10</sup> The budget deficit forecast for 2021 is -3.2% (down 0.4% from 2020). Special operations for corporate debt are reduced from CNY 4.65 trillion to CNY 3.65 trillion (USD 718 billion to USD 563 billion). **“Total social financing” (i.e., credits made available to private actors by the financial system) is also down considerably:** CNY 3.35 trillion in March 2021, compared to CNY 5.15 trillion in March 2020 (USD 516 billion vs. USD 796 billion). The M1 money supply only increased by 7.1% YoY – but renminbi loans, largely to individuals, increased by 12.6%, driven by real estate. The sector cooling measures implemented by local authorities and developers have resulted in a shift of new debt from housing promoters to buyers. On a year-over-year basis, the property price index for the 100 largest cities is up 4.07% in March.

The M2 measure remains more expansionary (+9.4% YoY, but -0.7% month-over-month).<sup>11</sup> **This is still a far cry from the quantitative easing measures taken by other major central banks.**

## RISK ASSESSMENT AS A BENCHMARK FOR FISCAL AND MONETARY POLICY

Clearly, **faced with the consequences of the pandemic, China is not following the policy of other major economies.** Support has gone to production, monetary expansion has been contained, the most developed regions and those best integrated into the global economy have taken the lead, as have large companies. **“China is the only major economy to have normalized its economic policy in 2020”** in favor of **“stability”**, notes one Chinese analyst.

As recently as April 2021, an official statement from the Political Bureau emphasized international uncertainties, thereby justifying the relatively low level of support for the economy: “Currently, the economic recovery is uneven, and its foundation is still not solid.”<sup>12</sup> The statement mentioned **domestic financial risks, the impact of foreign economic policies, technological containment efforts, and potential damage to value chains**, among other things, in a list including both economic and geopolitical risks, which also covers the precautionary import inventories established in March.

China is therefore the only major economy to normalize both its fiscal and monetary policies – **clearly counting on others to drive global growth by subsidizing demand, while China will freeride these efforts and boost its supply side economy.**<sup>13</sup>

But Chinese economists have divergent views on risk assessment and the effectiveness of fiscal and credit policies.

On the one hand, there is the estimate placing **China’s overall debt (household, corporate, government) at CNY 250 trillion (USD 38 trillion) or 246% of GDP**

<sup>10</sup> Andrew Batson, “Strategy Monthly: China’s Multi-Dimensional Tightening”, Gavekal Dragonomics Research, May 3, 2021, <https://web.gavekal.com/search-result?s%5B%5D=3>

<sup>11</sup> Pan Pan, “March: Social financing growth rate decline does not hide the real financing needs, Monetary policy will remain ‘stable’ at the forefront (3月社融增速下滑不掩实体融资需求, 货币政策仍将“稳”字当头)”, China Finance 40 Forum (中国金融四十人论坛), April 12, 2021, [https://mp.weixin.qq.com/s/Kui\\_Ru3MT-1elZ8ndBfZsA](https://mp.weixin.qq.com/s/Kui_Ru3MT-1elZ8ndBfZsA)

<sup>12</sup> Frank Tang, “China’s Politburo targets economic risks to ensure post-pandemic recovery”, *South China Morning Post*, April 30, 2021, <https://www.scmp.com/economy/china-economy/article/3131830/chinas-politburo-targets-economic-risks-ensure-post-pandemic>

<sup>13</sup> Huang Yiping (Chairman of the China Forum 40 Academic Committee), “Interview: China’s Monetary Policy, Trend of RMB Exchange Rate and the Opening of Capital Market in 2021”, China Forum 40 (中国金融四十人论坛), January 28, 2021, [http://www.cf40.com/en/news\\_detail/11673.html](http://www.cf40.com/en/news_detail/11673.html)

– a percentage often brought up by foreign estimates<sup>14</sup>, that does not include future liabilities such as pensions, which Chinese economists do not usually mention. **New private debt in 2020 represents 18% GDP points, with the rise in mortgages considered the main factor.** Behind this observation lies a fundamental analysis: unlike major developed economies, China still depends on fiscal and budgetary leverage to support (or slow down) its economy. **Monetary policy, and in particular interest rates, are said to play an insufficient role.** Even when the People's Bank of China provides commercial banks with liquidity, they do not lend enough. The growth of the M2 money supply relies primarily on local government debt. **“Stability” and “risk prevention, maintaining reserves (or “policy space”) for a counter-cyclical policy in the event of an international downturn, and giving priority to the economy’s “endogenous dynamics” are considered crucial.**<sup>15</sup> The level of public debt reached in September 2020 (USD 11.7 trillion) should remain the peak. Money creation and “social financing” should essentially follow nominal GDP growth: **these views recommend upholding neutral monetary and fiscal policies.**

But **other analyses – or some of their components – follow a bolder scenario.**<sup>16</sup> In fact, the People's Bank of China and official communication are criticized for often being **ambiguous in form and indecisive in substance:** “a little bit of this and a little bit of that”,<sup>17</sup> when the choices of easing or tightening policies should be clearly stated. Among the factors mentioned is the **persistent absence of any inflation other than that imported** through the rise in commodities and energy (which generated a 0.4% price increase in April 2021). The consumer price index was even negative in February-March 2021: **and yet, interest rates are not only positive but have even risen, a unique instance in that time frame among the major economies.** Domestic debt is “a mirror image of high savings rates” and a consequence of an underdeveloped stock market (in 2018, 47% of GDP versus 148% in the US). **A more aggressive monetary policy would strengthen the financial sector.** In what is the only implicit criticism of China's leader that we could find, an analyst who is critical of an unbalanced policy in favor of the supply side recommends adhering to “Xi Jinping's thoughts on socialism”, but also “following the laws of economic development.”

14 The Bank of International Settlements (BIS) data for “total credit to the non-financial sector”, obtained from China's central bank, stands at 285 % of GDP as of Q3 2020. “Total credit to the non-financial sector (core debt) As a percentage of GDP”, Bank for International Settlements, <https://stats.bis.org/statx/srs/table/f1.1>

15 Zhen Zheng (Director of PRC's Research Institute on market and prices), “How will China's cross-cycle macro-control policies be designed in 2021? (2021年, 我国跨周期宏观调控政策如何设计?)”, China Finance 40 Forum (中国金融四十人论坛), March 2, 2021, <https://mp.weixin.qq.com/s/1BRwNTXqLzTZiQxok8owEA>

16 Zhang Bin, “Active use of monetary policy, Reduce reliance on fiscal stimulus (张斌: 积极使用货币政策, 减少财政刺激依赖)”, China Finance 40 Forum (中国金融四十人论坛), April 9, 2021, <https://mp.weixin.qq.com/s/gjFQs1cGWFaWraBxcWgIWg>

17 Zhu He, “Before the third quarter, Macro policy should not turn lightly (第三季度前, 宏观政策不宜轻言转向)”, China Finance 40 Forum (中国金融四十人论坛), April 12, 2021, <https://mp.weixin.qq.com/s/cl2a9GfSmzT1zttQV9kpPQ>

Recommendations, which sometimes go beyond the financial domain alone, also emerge alongside these analyses: **if Chinese migrants (395 million, of which 125 million are interprovincial migrants) were given the same access to public services as permanent urban residents, their per capita consumption would increase by 27%.**<sup>18</sup> More broadly, the proactive monetary policy of the (other) developed economies during the pandemic is said to benefit above all the most underprivileged part of the population by protecting employment or income.

Noted economist Yu Yongding argues that **“it is too early to stop an expansionary monetary policy”** (which, as we previously explained, does not really exist...).<sup>19</sup> The bad debt ratio of commercial banks does not exceed 2% of deposits vs. 25% in the late 1990s. Their capital adequacy ratio is 11.7%, which meets the BIS criteria. **“There can be no banking panic” and “capital flight can be easily contained”:** Yu Yongding's view is obviously based on the assumption of the currency's non-convertibility and capital controls. According to him, the example of Japan in the 1990s proves that there is no identifiable threshold for risk on public debt. In 1999, China disregarded the World Bank's recommendation on this point and “was right to do so”. **In the end, “growth is the final arbiter”, as it reduces the debt burden.**

According to another analysis, “maintaining sufficient exchange rate flexibility is enough to counter possible capital flight and avoid ‘getting fleeced’ (*sic*) by the United States”. From this, we can deduce that **the dollar peg remains the central element of the monetary policy, with a high degree of vulnerability to the Fed's decisions on interest rates.** One PBoC official from Shanghai has gone farther, advocating a reevaluation of the renminbi vs. the US dollar to stem imported price inflation. The PBoC as such has come out against this view ascribed to lower officials, and announced it would continue to keep the exchange rate at a “basically stable” level. Yet, the director of the PBOC's financial research institute, Zhou Chengjun, recommends the adoption of a free-float for the renminbi: he notes that in the past two years, the renminbi has been the world's most volatile major currency, and declares that the central bank “no longer intervenes to fix the exchange rate”:<sup>20</sup> however doubtful that last assertion may be, it does signal an active debate.

18 Wang Yiming, “Monetary policy must avoid both credit contraction and strengthening of inflation expectations (货币政策既要避免信用收缩, 也要避免通胀预期强化)”, China Finance 40 Forum (中国金融四十人论坛), April 13, 2021, <https://mp.weixin.qq.com/s/SMqSHS2hVdvnmuC1lcoig>

19 Yu Yongding, “Yu Yongding's in-depth analysis of the macroeconomic situation in 2021 (余永定深剖2021年宏观形势)”, China Finance 40 Forum (中国金融四十人论坛), January 31, 2021, <http://www.cf40.org.cn/detail/11681.html>





20 “PBOC Says It Will Maintain Exchange Rate ‘Basically Stable’”, *Bloomberg*, May 23, 2021, <https://www.bloomberg.com/news/articles/2021-05-23/pboc-says-it-will-maintain-exchange-rate-basically-stable>

Then, of course, **China's central bank has never been the master of its policies.** Looking at the overall debate, one notices that participants proceed from very different assumptions: Yu Yongding and others advocate more deficit spending and support for demand within the framework of a controlled currency and capital controls.<sup>21</sup> Some PBoC cadres advocate – yet again – what amounts to a currency and capital liberalization, allowing for a truly global role of the renminbi.

True to his past as an international negotiator, Long Yongtu recommends that **China “become the world's leading importer”,** including through massive imports of commodities, components, and the most sophisticated products and services:<sup>22</sup> **at the WTO, importers are the ones who make the rules, not exporters.** Long does not allude to the geopolitical aspect of this inventory policy, but another analysis mentions the need for China to fill its productive gaps in areas where it does not have enough “hidden champions”: the term refers to companies that are the most innovative but not necessarily the largest, and which are crucial in the high-tech field. A recent Japanese source provided the striking example of YMTC (Yangtze Memory Technologies Co.), which is sourcing missing technologies worldwide, with the authorities' support, to move towards self-sufficiency in the semiconductor field.<sup>23</sup>

### China's hidden chip champions

(Breakdown by chip production process)

Chip production process	Chinese players	Foreign incumbents
 <p><b>Design tools</b> (Electronic design automation tools or EDA) Software tools for chip designers to map out their ideas into blueprints</p>	Empyrean, Xpedic, X-Epic, Shanghai Hejian Industrial Software, Advanced Manufacturing EDA	Synopsys (U.S.), Cadence Design Systems (U.S.), Siemens EDA (Germany), Ansys (U.S.)
 <p><b>Design</b> (Including IP, blueprints) Use EDA tools to design integrated circuits</p>	Huawei's HiSilicon Technologies*, Will Semiconductor, UNISOC, Goodix	Apple's chip design arm Nvidia (U.S.), Qualcomm (U.S.), MediaTek (Taiwan), Arm (U.K.)
 <p><b>Manufacturing</b> Produce chips based on chip designers' blueprint</p>	SMIC*, Hua Hong, Yangtze Memory Technologies, ChangXin Memory Technologies, and more	TMC (Taiwan), Intel (U.S.), Globalfoundries (U.S.), Samsung (South Korea), SK Hynix (South Korea), Micron (U.S.), Kioxia (Japan), and more
 <p><b>Packaging and testing</b> Final assembly and testing functionality</p>	JCET, Tongfu, Microelectronics, Tianshui Huatian Technology	ASE Tech Holding (Taiwan), Amkor (U.S.)

\* Added to U.S. Entity List

Source: Cheng Ting-Fang, Lauly Li, “US-China tech war: Beijing's secret chipmaking champions”, Asia Nikkei, May 5, 2021, <https://asia.nikkei.com/Spotlight/The-Big-Story/US-China-tech-war-Beijing-s-secret-chipmaking-champions>.

In sum, advocacy for **a more expansionary macroeconomic policy** is based on different arguments: one is that **an expanding demand will boost growth and reduce debt.** Another is, simply, that **China's finances and currency reserves can well afford this policy,** and that capital controls in place provide insurance against capital flight and any financial crisis. Support for a lifting of capital controls and renminbi liberalization also implies a more competitive and privately managed economy. Finally, there is the argument that **an open door to imports is in support of China's plans to move up the innovation and technology chain, and compatible with China's official policy of technological upgrading through subsidies and purchases of companies abroad.** Not all of the above arguments

21 Yu Yongding, “Yu Yongding's in-depth analysis of the macroeconomic situation in 2021 (余永定深剖2021年宏观形势)”, China Finance 40 Forum (中国金融四十人论坛), January 31, 2021, <http://www.cf40.org.cn/detail/11681.html>  
 22 Lu Yongtu, “Our past foreign trade centered on foreign exchange, In the future imports should be vigorously increased (我们过去的外贸政策以外汇为中心, 今后要大力增加进口)”, China Finance 40 Forum (中国金融四十人论坛), March 1, 2021, <https://mp.weixin.qq.com/s/Z-NfCq-xsAz0DDcFUpba3A>  
 23 Cheng Ting-Fang, Lauly Li, “US-China tech war: Beijing's secret chipmaking champions”, Asia Nikkei, May 5, 2021, <https://asia.nikkei.com/Spotlight/The-Big-Story/US-China-tech-war-Beijing-s-secret-chipmaking-champions>

are mutually compatible, of course, and this makes us infer that what we are looking at is an experts' debate and not a frontal clash between two macroeconomic policy options.

Regardless of these interesting debates, the government's objectives for 2021 – stabilizing the total supply of credit at the 2020 level, limiting the increase in budget spending to 4.6% for the year, controlling the real estate boom, and as discussed below, slowing down and even reducing production in the most energy-intensive industrial sectors (steel, cement, aluminum, glass) all point in the same direction: **each implies a significant reduction in support for the supply economy and a possible slowdown in growth.** It is clear that **maintaining an export dynamic, which was an essential pillar of growth in 2020, remains a priority.**



## THE ECONOMIC STAKES OF DECARBONATION

Xi Jinping's pledge at the UN in September 2020 – to have China's carbon emissions peak before 2030 and reach carbon neutrality by 2060 – was undoubtedly made in the context of the dramatic rise in Chinese emissions in 2020. But it was also a striking shift from the draft of the 14<sup>th</sup> Five-Year Plan, which was being finalized and provided few quantified targets. **Until then, China's main hard target was for energy intensity per unit of GDP. Its international stand was often defensive, highlighting the differentiated requirements for developed and developing economies.**<sup>24</sup>

**It seems that Xi opened the way for a revision of energy policies that goes beyond changes in the shares of different primary energy sources.** As is the case with the “greening” of the European economy, if there is any chance of achieving the targets set, China will need to take account of the content of its growth. And as is also the case in Europe, **a less desirable alternative is simply slower economic growth.** This is hardly a pleasant scenario for the Chinese government, which, in this case, is defending its right to “catch up” with the past amount of CO<sub>2</sub> emissions of industrialized countries. Recently, the Chinese account of the telephone conversation between Xi Jinping and his French and German counterparts implicitly criticizes the European plans for a carbon adjustment tax at the borders by stating that **climate change should not become “an excuse for trade barriers (贸易壁垒的借口)”**.<sup>25</sup>

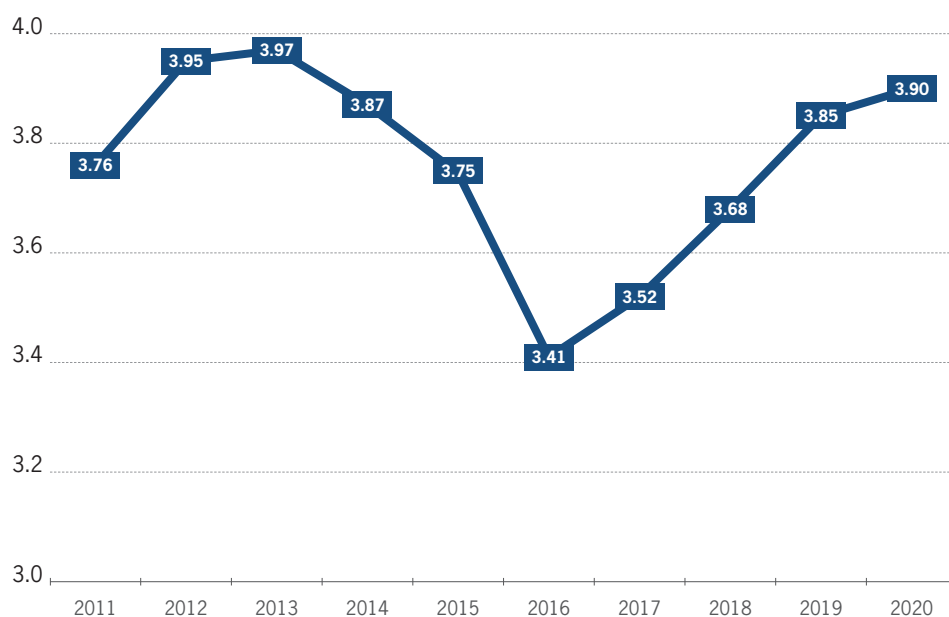
Three observations can be made about the recent past (since 2013) and the trend in 2020: **coal consumption has returned to its 2013 peak** (4.2 billion tons). In addition to this momentous production, China also imports large quantities of coal – for instance, 304 million tons in 2020. Coal supplied directly 58% of primary energy consumption in 2020 (vs. 76% in 2013). But its role in electricity generation (65%) is higher than installed capacity (50%) because the flexible share

<sup>24</sup> Ministry of Ecology and the Environment, “China's Policies and Actions for Addressing Climate Change (2019)”, November 2019, <https://english.mee.gov.cn/Resources/Reports/reports/201912/P020191204495763994956.pdf>  
<sup>25</sup> “Xi Jinping holds a video summit with French and German leaders (习近平同法国德国领导人举行视频峰会)”, *Xinhua*, April 16, 2021, [http://www.xinhuanet.com/politics/leaders/2021-04/16/c\\_1127339605.htm](http://www.xinhuanet.com/politics/leaders/2021-04/16/c_1127339605.htm)

(gas turbines and pumped storage hydropower) is very low in China (6%, compared to 18%, 34%, and 49% respectively in Germany, Spain, and the United States).<sup>26</sup> The world's largest nuclear power program, which was slowed down after Fukushima but is essential to achieve decarbonized energy, is only marginally included in the overall balance sheet: 3% of capacity and 5% of electricity production. An increase in capacity from 52 to 70 gigawatts is planned in the 14<sup>th</sup> Plan – which implies a substantial acceleration of projects. Hydropower capacities are mostly developed already, except in China's distant Southwest where there are costly and difficult projects.<sup>27</sup> Pumped storage hydroelectricity is now planned, as it could complement irregular wind and solar energy.

### China's Annual Production of Raw Coal

(billion tons, 2011 – 2020)



Source: Statistics published on the website of the National Bureau of Statistics of China.

26 Muyi Yang, Xunpeng Shi, Aditya Lolla, "China was the only G20 country to see large increase in coal generation in 2020", EMBER, March 2021, <https://ember-climate.org/global-electricity-review-2021/g20-profiles/china/>  
 27 Mark Doman, Katia Shatoba, Alex Palmer, "A mega dam on the Great Bend of China", ABC News, May 25, 2021, [https://www.abc.net.au/news/2021-05-25/chinas-plan-to-build-mega-dam-on-yarlung-tsangpo-brahmaputra/100146344?utm\\_campaign=news-article-share-control&utm\\_content=twitter&utm\\_medium=content\\_shared&utm\\_source=abc\\_news\\_web](https://www.abc.net.au/news/2021-05-25/chinas-plan-to-build-mega-dam-on-yarlung-tsangpo-brahmaputra/100146344?utm_campaign=news-article-share-control&utm_content=twitter&utm_medium=content_shared&utm_source=abc_news_web)

More worryingly, **electricity consumption is not discouraged at all: the price of power has fallen since 2018 by 23% overall and 17% for urban industrial users.** This explains local governments' enthusiasm regarding coal-fired power plants, which have the lowest operating cost.<sup>28</sup> On the other hand, these are costly investments. Indeed, to its credit, China now only installs (and exports) supercritical thermal power plants, which can take 30 to 40 years to achieve break even point, thereby casting doubt on a rapid conversion to other energy sources.

In the spring of 2020, as part of the support for the economy, **Premier Li Keqiang's annual government report speech continued to place economic profitability first and emphasized "clean coal"**. So far, efforts have gone to rationalize coal production – shuttering 5,500 inefficient mines, resettling 1 million miners: this lowers the coal production capacity but not necessarily coal production itself. The large power players have simultaneously pushed for a huge thermal power plant program. By February 2020, a policy created in 2017 (dubbed the "traffic light" system) to regulate the creation of new thermal power plants was significantly relaxed. According to the annual report of the China National Coal Association,<sup>29</sup> China will cap coal production at 4.1 billion tons in 2025 (still an increase), and coal consumption at 4.2 billion tons – implying lower coal imports.

Should these numbers be relativized in light of a **decrease in CO<sub>2</sub> emissions per unit of GDP**, which the Chinese government often highlights? This decrease reached **18% between 2015 and 2020, and the 14<sup>th</sup> Plan sets a roughly equivalent reduction target (18.8%) between 2021 and 2025.** Unfortunately, as conceded by several Chinese analyses, the actual amount of CO<sub>2</sub> emissions is unknown outside of the largest companies, mostly SOEs. There is therefore no measuring scale, or perhaps only for large-scale industry. This skepticism extends to Zhou Xiaochuan, the former PBoC governor and now green finance guru: he has indirectly cast doubt on Xi's new pledges to reduce the energy consumption per unit of GDP. While Xi has pledged a reduction in 2030 by 65% from a baseline in 2005, Zhou drily notes that CO<sub>2</sub> measurements were inexistent in 2005, and assails the "inconsistent bases and indexes for 2005 (gross emissions vs. net emissions, carbon dioxide vs. greenhouse gases, for example). Diverse calculation bases generate diverse planning data".<sup>30</sup>

28 Lauri Myllyvirta, Shuwei Zhang, Xinyi Shen, "Analysis: Will China build hundreds of new coal plants in the 2020s?", Carbon Brief, March 24, 2020, <https://www.carbonbrief.org/analysis-will-china-build-hundreds-of-new-coal-plants-in-the-2020s>

29 China National Coal Association, "2020 Coal Industry Development Annual Report (2020 煤炭行业发展年度报告)", March 4, 2021, <https://www.coaledu.net/c/2021-03-04/45609.shtml>

30 Zhou Xiaochuan, "Weekend Long Read: Zhou Xiaochuan on the Key Questions Facing China's Carbon Ambitions (Part I)", Caixin, April 10, 2021, <https://www.caixinglobal.com/2021-04-10/weekend-long-read-zhou-xiaochuan-on-the-key-questions-facing-chinas-carbon-ambitions-part-i-101688319.html>

The solutions, should the government be looking for them, are therefore difficult to find and necessarily complex, with substantial economic implications. **In 2020, the recovery was achieved through supply-side economics and support for traditional sectors.** Steel production soared to 1.065 billion tons (60% of world production), while aluminum production reached 37 million tons (half of world production). **The metals industry alone absorbs 20% of the energy produced in China.** China also produces **2.2 billion tons of cement (60% of global production and 21% of China's CO<sub>2</sub> emissions** as estimated by the IEA). In comparison, the transportation industry accounts for only 10% of total CO<sub>2</sub> emissions. It is expected that 70% of new buildings in major cities will be “green” buildings and modular ones if possible. The question of the contribution of Chinese exports to CO<sub>2</sub> emissions (which are subtracted from the carbon balance of importing countries) is far from clear: their share of emissions cannot – by far – equal that of the primary products mentioned above.

In the face of this dilemma, several types of policies are being implemented or considered for implementation. **In the very short term, the government decided in 2021 to reduce production in the most energy-intensive sectors,** starting with steel production, which should fall below its 2020 level this year. In February, it increased certain export taxes on steel products while eliminating import taxes on cast iron, scrap steel, and semi-finished steel.<sup>31</sup> Other yet unspecified measures are being considered for aluminum, caustic soda, and cement.

The policy seems to consist in moving forward sector by sector and area by area, with the most advanced regions making a greater effort. The residential sector of very large cities such as Beijing has put an end to coal-fired heating in buildings and the use of briquettes in individual homes. Some areas – Shanghai, for example – are adopting differentiated electricity tariffs at the expense of the most energy-intensive industries, starting with steel.

Xi Jinping recently escalated an **anti-corruption campaign launched in 2019 in the coal and thermal power plant industries in Inner Mongolia.**<sup>32</sup> It retroactively covers the last twenty years, thereby implicating thousands of managers. At the end of 2019, the province alone totaled 530 coal-fired thermal power plants.

31 “China Wants More Steel at Home as Industry Faces Overhaul”, *Bloomberg*, April 28, 2021, <https://www.bloomberg.com/news/articles/2021-04-28/china-to-remove-import-tariffs-on-some-steel-products-from-may>  
32 Yu Changhong et al., “Survey on 20 Years Corruption Investigations in Wujin, Inner Mongolia (内蒙古乌金腐败倒查20年观察)”, *People's Daily*, April 25, 2021, <http://pic.people.com.cn/n1/2021/0426/c1016-32088314.html>

Beyond this short-term struggle in the most cyclical sectors, **a vast and complementary range of measures is considered – but often without a national plan or overall quantitative objective.**<sup>33</sup> This is admittedly very difficult to implement, in any country or system. The measures cover the use of renewable energies; an acceleration of the roll-out of electric cars starting with the wealthiest regions (35% of automobile production in Shanghai in 2025); a one-of-a-kind plan for public charging stations (in December 2020 alone, 117,000 stations were put into service, whereas the entirety of the EU totaled only 250,000 public charging stations at the same date); and a plan to **increase interconnection for electricity by State Grid.** By 2025, the plan is for provincial or regional interconnection to reach 14% of generation capacity, of which 50% for decarbonized energy.

Other moves include, in 2021, an end of subsidies to wind and solar investment. This is designed to prevent the local oversupply of capacities that might then stay unused. But it also means that the profit margins for these energy producers have been tightened. Another development is also in question: China leads the world in terms of green bond emissions. But it turns out that the criteria used to define their use have been loose<sup>34</sup>: in 2021, so-called “clean coal”, only a year ago a mainstay of official speeches, is now excluded from green financing. Commentators also note that up to a third of these green bonds have actually been used to “provide liquidity” to ailing companies by local authorities.

Undoubtedly, it will be a challenging undertaking. While this is the case throughout the world, it is especially true in a country where the **price of coal is low, the price of gasoline was formerly subsidized and then subject to a low tax regime, and where electricity tariffs encourage consumption. This is part of the socio-economic system and helps to ensure social stability – a key priority for the Chinese Communist Party.**

One **essential issue is that of market incentives, i.e., not only a carbon tax mechanism, but also a mechanism for setting carbon emission trading prices.** This is an option that Zhou Xiaochuan, the former governor of the Central Bank and promoter of carbon emissions trading, has been advocating.

33 Michal Meidan, “Unpacking China's 2060 carbon neutrality pledge”, The Oxford Institute for Energy Studies, December 2020, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2020/12/Unpacking-Chinas-carbon-neutrality-pledge.pdf>

34 Peng Qinqin, Guo Yingzhe, “Regulators Can't Keep Up With China's Growing Carbon Financing Market”, *Caixin*, May 7, 2021, <https://www.caixinglobal.com/2021-05-07/in-depth-regulators-cant-keep-up-with-chinas-growing-carbon-financing-market-101707902.html>

A national carbon pricing system has been long delayed, following several pilot projects since 2011. It is worth noting that this date closely follows the French carbon tax project, which the French Conseil constitutionnel rejected: China had taken this external risk seriously, and the introduction of an internal tax was also intended as a means of defense before the WTO. China's advocates of a carbon tax in fact cite again this international risk as a factor.

An interesting analysis suggests a **coordinated but differentiated combination of a carbon tax and an ETS carbon price market**.<sup>35</sup> This starts from the realization that current options for energy saving on the production side are not enough to reach the 30/60 targets. It is the structure of the economy, and consumption habits, that must be nudged in order to change: we might add that China has already announced and attempted to reduce its coal consumption twice in the past (in 1997 and 2013).

The carbon tax would be globally **neutral from a fiscal perspective**, i.e., compensated by tax cuts to avoid harming the economy and to be socially acceptable. It would apply to **companies that have not entered the emissions trading market: small and medium-sized enterprises**. It would be based on previous energy taxes (on coal and fossil fuels), but it would be levied on energy users, not energy producers. It would have a single rate. While unfair since this rate would be common to different sectors with different energy needs, this single rate would simplify collection. It would start out very low, then be raised. **In effect, this tax would be passed on from production to consumers – thereby encouraging energy conservation.**

Companies entering the emissions trading scheme would be exempt from the carbon tax. **Both systems would be coordinated to avoid excessive disparities between the carbon tax and market pricing with the former being raised if the latter collapsed.** A spot market pricing system discourages the long-term investment that is needed for alternative energy.

35 Fu Zhihua, Xu Wen Cheng & Cheng Yu, "The carbon market cannot be enough to achieve the 30/60 goal, the introduction of a carbon tax must be an important policy choice (仅靠碳交易难以实现“30-60”目标, 开征碳税应成为重要政策选项)", China Finance 40 Forum (中国金融四十人论坛), April 8, 2021, <https://mp.weixin.qq.com/s/YyQpAgC2dQk0yn2qCmGtzQ>

## THE DEMOGRAPHIC SHOCK: HOW SOON?

The results published so far from China's 2020 decennial census<sup>36</sup> have implications for the Chinese economy. They provide a snapshot of the population that brings some surprises. The consequences for the most widely publicized trend – **a sharp drop of total fertility to 1.3 – may not be immediate or even short-term. Nonetheless, the trend changes perceptions of the future Chinese economy, its human resources and social burden.**

For the present, the most salient fact is the very divergent regional trend over the last decade since the previous 2010 census.<sup>37</sup> **They reveal a two-speed China where regional development is clearly unequal, as viewed from population trends.** While the population of Guangdong, a coastal province of southeast China, grew by 20% in this decade, the three Northeastern provinces saw a decline of more than 10%. Other inland provinces, such as Shanxi, Inner Mongolia, and Gansu, also saw an absolute decline. Yet six new cities have passed the 10 million mark, including far away from the coastal provinces. The fastest growing of these new 10 million+ cities, Changsha (Hunan) and Xi'an (Shaanxi), saw an increase of more than 40%. Surprisingly, Xinjiang still sees a growth of its population – the extraordinary decline in fertility in the last three years is compensated by new Han immigrants.

Overall, it is clear that demographic trends and migrations follow the economy. One is tempted to add that it does not follow official demographic policy. The relaxation of the one-child policy only brought a short increase in second births at the beginning. Family size is steadily decreasing – from 3.12 in 2010 to 2.53 in 2020. **Not only is the “three generations under one roof” model a thing of the past, but it is clear that universal marriage is no longer the norm, while**

36 "Press conference answering reporters' questions on the main data results of the seventh national population census (第七次全国人口普查主要数据结果新闻发布会答记者问)", National Bureau of Statistics of China, 11 May, 2021, [http://www.stats.gov.cn/tjsj/zxfb/202105/t20210511\\_1817274.html](http://www.stats.gov.cn/tjsj/zxfb/202105/t20210511_1817274.html)

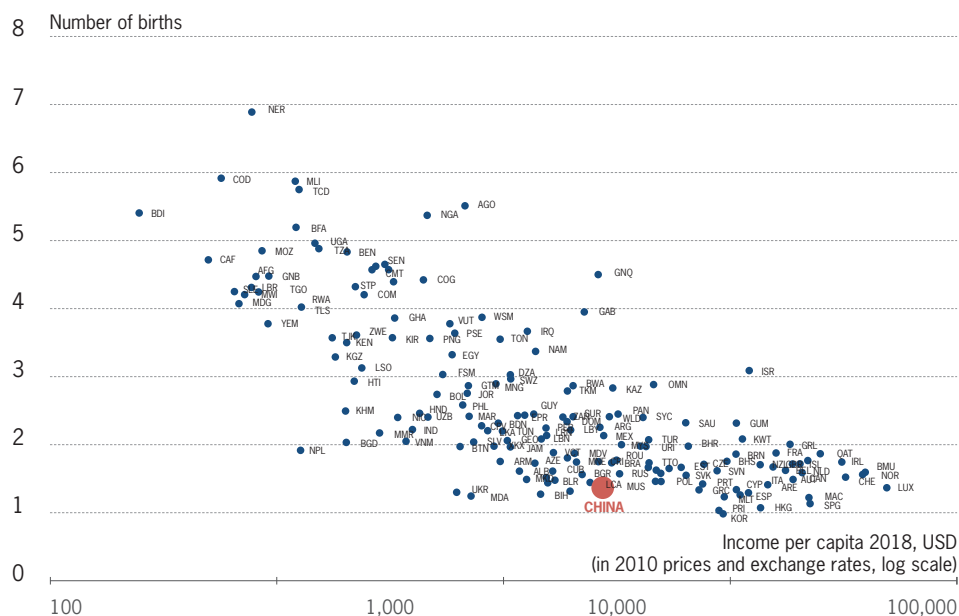
37 Xu Mingyue, Zhang Wei, Yang Qihong, "21 provinces' data from the 'Seventh national census' released one after another, 'Hukou' welcomes 5 major changes (21地“七人普”数据陆续发布, “户口本”迎5大变化)", People's Daily, May 24, 2021, <http://unn.people.com.cn/n1/2021/0524/c14717-32111759.html>

**divorce rates have soared.** Other trends also show dynamism, such as the rise in college educated and above in the population rose to 14.5%. In Beijing, Shanghai and Tianjin it is 42%, 34% and 27% respectively, while in Tibet it is 11% – still a doubling in one decade.

**China follows the demographic transition in other societies** – as income and education improve and urbanization becomes predominant, birth rates go down. The softening of the one-child policy appears only as a blip on the radar.

However, there is an important difference with predecessors in the transition: **the birth rate in China has actually gone down earlier and faster than it has in other societies**, including in East Asia. China has arrived at the fertility rate of South Korea in 1995.

**Total Fertility Rate and Income Per Capita**



Source: Bert Hofman's Newsletter, "China's Population Census", May 12, 2021, data drawn from World Development Indicators and National Bureau of Statistics of China; all data of 2018, except China (2020).

It is not a mere coincidence. In the first half of the 1990s, Korea's sex ratio at birth also hit a high – 117 in 1991, above 114 in 1993-1995 – along with the preference for boys and the generalization of echography. China's sex ratio at birth has risen above 110 since 1987, hit a high of nearly 119 in 2005, has improved below 115 only since 2013, and is estimated to be 111.3 in the new 2020 census. For both societies, this has meant a much lower number of women of childbearing age. According to Liang Jianzhang, an economist who came out early against the one-child policy, **the number of women aged between 22 and 35 is expected to fall by 30% in the next decade.**<sup>38</sup> This implies that even if the total fertility rate were to improve, the yearly birth rate relative to the population would still not rise as quickly. In South Korea, both rates have kept declining.

The consequences are clear: **China's population will enter an absolute decline earlier than 2025** (which was the official prediction), and perhaps as early as 2021. And the downward cycle will be difficult to break, leading to more population aging. According to one analyst citing unpublished data from the 2020 census, the segment above 60 is already 18.7% of the population. This is the relevant index, since men retire at 60 (and women at 55), while figures published so far track the over 65 segment (now 13.5% of the total population).

But are the economic consequences so clear in the immediate future? This is much less obvious. The same census indicates that the 0-14 share of the population actually increased from 16.60 to 17.95 % between 2010 and 2020. And regional migration has been strong – the total number of migrants is estimated in 2020 at 365 million, of which 125 million are interprovincial migrants. The labor force age ratio to the overall population still stands at 63,35%, one of the highest in the world. According to a well-argued Chinese view, "in the coming period, the concern is not labour shortage, but structural unemployment, where a lot of low-end labour has already been replaced, especially in counties with a moderately low level of development and labour-intensive industries". **The main impact of a birth rate crash and fast ageing is on the demand side: it is likely to inhibit consumption.** This is therefore an argument for those who advocate support to the demand side of the economy. The full demographic impact of the fertility bust will only be felt in a few years.<sup>39</sup>

38 Zhang Hui, Liu Xin, "Is China's birth rate low enough to cause population crisis?", *Global Times*, May 13, 2021, <https://www.globaltimes.cn/page/202105/1223326.shtml>

39 Yao Yang, Director of the Institute of National Development Studies, Peking University, "Will pensions fall short as ageing population takes its toll? (人口老龄化带来冲击, 养老金会亏空吗?)", *Guancha*, May 17, 2021, [https://www.guancha.cn/YaoYang/2021\\_05\\_17\\_590963.shtml](https://www.guancha.cn/YaoYang/2021_05_17_590963.shtml)



Proposals to counter the trend are making the rounds of China's official media. One that has received heavy publicity is also by Liang Jianzhang, cited above: every woman would receive a CNY 1 million (USD 157,000) award for each birth. Without a full endorsement, and while explaining that the drop in fertility cannot be fully reversed, Cai Fang, chief expert of the National High-End Think Tank at CASS, also suggests a welfare policy targeting women and births.<sup>40</sup> The press reports that official policy will now allow three children per family.<sup>41</sup> Other economists point out **the need to improve productivity and highlight an “engineer dividend” that would replace the “demographic dividend” that is now vanishing.**

Indeed, it is very hard to infer from demographic trends a future economic path. A smaller workforce would also solve the rural unemployment problem – which at present is never measured. Many environmental targets – starting with CO<sub>2</sub> emissions – will be easier to reach with a smaller population. The one issue which is certain to become critical is that of retirement age and retirement planning, including by redistribution.

40 Cai Fang, “China’s fertility rate falls to 1.3; Cai Fang: Preventing demand-side shocks after total population peaks (中国生育率跌至1.3, 蔡昉: 防止总人口达峰后的需求侧冲击)”, China Finance 40 Forum (中国金融四十人论坛), May 11, 2021, [https://mp.weixin.qq.com/s?\\_\\_biz=MjM5NjgyNDk4NA==&mid=2686031770&idx=1&sn=56a75c00b8e8e10cc8890e3783715174&chksm=830e656db479ec7b1187b4e6ef7837573dbb4e11cfe704f8cf987a56e2a8737768e72cf21e79&scene=21#wechat\\_redirect](https://mp.weixin.qq.com/s?__biz=MjM5NjgyNDk4NA==&mid=2686031770&idx=1&sn=56a75c00b8e8e10cc8890e3783715174&chksm=830e656db479ec7b1187b4e6ef7837573dbb4e11cfe704f8cf987a56e2a8737768e72cf21e79&scene=21#wechat_redirect)

41 Quanwei Kuaibao (Authoritative Express) information relayed by: “Three Children Policy Is Here (三孩生育政策来了)”, Xinhua, May 31, 2021, <https://news.sina.cn/gn/2021-05-31/detail-ikmyaawc8565283.d.html?from=wap>

## CONCLUSION

While 2021 began with renewed strong growth, how the rest of the year will unfold is now more uncertain, including regarding official macroeconomic policy choices. **The rebalancing towards consumption is slow and perhaps reversible. Housing investment through private debt seems to be the most striking feature of current individual behavior.** Although official forecasts do not say as much, **the continued increase of exports remains a priority, and the attention given to the CNY/USD exchange rate is a sign of this,** following a period of reevaluation in 2020. **A cautious, middle-of-the-road and mainly restrictive management of the economy is the other salient feature** – fiscal spending and credit policy are being curtailed, with interest rates remaining high, even in the absence of domestic inflationary pressures. However, **none of this seems to affect the sectoral policies that are most discussed abroad** – the considerable plans to support industrial innovation or the fight against poverty, not to mention military and homeland security budgets. It is clear that China's public finances keep room for maneuver in case of unforeseen developments, and the persistent current account surplus also allows for a continuation of investment and BRI policies abroad.

On the other hand, **there is growing pressure on the coal sector and the most energy-intensive industries** (steel and, less specifically, cement and aluminum) **via typical top-down means** (quotas and anti-corruption measures). An undesired side effect is that this contributes to a rise in prices for materials in line with the recent global inflationary trend. At the same time, **China is building up stocks of imports** – copper, soybeans, and semiconductors, for example – and one might ask whether this makes economic sense: by stockpiling, the huge consumer that is China is causing the very price rise it fears. As implied by some language in the 14<sup>th</sup> Plan draft, **this could also be seen as a geopolitical precautionary principle against the risk of an international crisis or sanctions.**

Overall, this should not conceal a great economic vigor, where the measure of public and private debt (246% of GDP) or future liabilities (pensions that are so far largely unplanned for an aging population) do not, in fact, exceed the levels found in some other developed economies.

**An interesting economic debate therefore opposes advocates of bolder choices against the precautionary policies that prevail currently.** In China, as elsewhere, an argument can be made that an increase in the demand side would better ensure growth. It might also help to phase out current debt, whereas support for the supply side is largely achieved by creating new debt.

The freshly published first results of China's decennial population census could support this proposition. A 15% drop in the birth rate in 2020 (before the full-year impact of Covid-19 is felt), an overall fertility rate of 1.3 – on par with South Korea's 2015 rate, while per capita income is much lower in China – and absolute population declines in several provinces (especially the three Northeastern provinces, where the drop is more than 10% over a decade) **all point to a reduced growth potential in the future.**

The climate challenge is a card that China also needs to play in international relations since the country represents both the most significant problem and a necessary part of any solution. Xi Jinping's new commitments are now leading to stronger, if not always quantified, public targets. We have noted at **least one bold, although informal proposal: the combination of a carbon tax and a carbon price market.** However, we should mention that this proposal largely ignores the socio-political context of consumers and employment. These are variables that influence energy choices around the world, and an authoritarian regime which restricts political freedom must stay attentive to socio-economic needs.

Therefore, it is **difficult to believe that the choice of a proactive expansionary policy favouring demand, focusing on the monetary tool demand as the G7 countries do, seizing the issue of economy greening through the combination of a carbon tax and carbon pricing, will actually be adopted.**

Nonetheless, that these proposals emerge in public expert circles is a sign that Xi Jinping's new climate commitments have kickstarted a round of questions on how to achieve them. The debate also reveals that **at least some Chinese experts have limited confidence in purely top-down policies, and are advocating for market mechanisms and incentives.** This is not a traditional liberal economic view – in fact, a strong and unwavering state is required to push these reforms through against established interests and constituencies – but it is still a proposal for reforms of a major order.

**What are the main take-aways for Europe and the countries which view China as a partner in cooperation, an economic competitor and a systemic rival?**

The first is China's perception of its own success. This is not only about riding out the pandemic (so far), but also about the surge in foreign investment and capital influx, and the epochal boom in exports. But how long will this last? **Maintaining this dynamic is a priority. China is not likely to concede on these grounds under Xi Jinping's watch.** Global markets and financial firms are also largely helping to support this rigidity.

The second is that China's economic decisions – including on decarbonation and demography – are largely shaped by domestic factors. The international factor is perceived as a risk rather than a constraint, and it remains largely identified with the actions of any US administration. One does not sense a perception of a risk from Europe, even in the area of trade and investment. **Whatever our own perceptions on the "change of mood" relative to China on our continent, this seems to go unnoticed - a blip on the radar.** A conservative macroeconomic policy, efforts to limit international dependency, all seem derived from China's perception of its relation with the United States.

The third is that **state capitalism, supply side policy support, industrial policies and innovation remain China's prevailing choice to foster growth.** Even advocates of another, more expansionary, monetary policy or green transition seem to rely largely on the state. There are, however, advocates of other policies – elements in the central bank, which is not a new development; perceptive observers have also noted the difficulties for China to reach greening goals: whether it is about capital liberalization or about energy transition via market mechanisms, all point out to an earlier, largely abandoned reform road.

The fourth is that since most policy developments are driven from above, and filter through the layers of China's economic and local bureaucracies, a key component of any international agreement must still insist on implementation and verification. Market developments – or such key demographic trends as the birth rate! – cannot be reversed by fiat. **Most changes in China remain driven by the party-state - and are therefore reversible.**

The fifth is that international demand drives China's growth; China's growth does not drive the global economy. In broad economic terms, **China remains a free-rider, achieving its economic rebound on the basis of a support for global demand by other central banks.** Again, on climate and the energy transition, the balance sheet is perhaps more mixed. China does need to curb its CO<sub>2</sub> emissions because it suffers from climate change, as they account for 30% of global emissions. Political and social factors make it hard to achieve, and China's leaders have abundantly repeated that they will not sacrifice their growth. They also tend to use climate issues as a talking item in global governance, and remain very imprecise about the measurement of progress in reaching their climate goals.

In bilateral relations with China, at fora such as the G7 and G20, partners should **question China on its willingness to support the global economy** as befits its status as the world's second economic power. At climate conferences, they should also **put an accent on the concrete steps**, including international verification, that China intends to take to achieve ambitious but distant goals.

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This policy paper unfolds some of these debates and provides a glimpse at China's internal assessments of the global pandemic's impact and its growth prospects. These views are mostly about the Chinese economy itself and its fiscal and monetary policies. The international angle is viewed with primary attention at present and future U.S. policies. Other economies, including Europe, seem to go unnoticed.

The most common element dominating these perspectives is uncertainty, due to external factors. It serves to explain neutral budget and credit policies, against the advocates of a more proactive monetary policy. China's fear of a global rise of inflation, as well as precautionary geopolitical moves, currently lead to the preemptive purchases of primary products and stockpiling of IT components.

The note identifies five take-aways for Europe and the countries which view China as a partner in cooperation, an economic competitor and a systemic rival.

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