Opinion **Chinese economy**

China's plenum must offer action not rote slogans

The country's problems are both cyclical and structural and need tackling on multiple fronts

ESWAR PRASAD

Li Qiang, Chinese premier, recently spoke about dealing with the symptoms as well as root causes of the current problems but offered few remedies © Ng Han Guan/AP

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The mood in China is dismal. Indicators of domestic and foreign sentiment — household consumption, private investment and inflows of foreign capital — have been anaemic. Property values continue to fall and the stock market is in the doldrums, both reflecting and feeding into the sense that the economy is rudderless and that the government either doesn't understand the gravity of the situation or doesn't have a plan to stem the rot. Or both.

The third plenum of the Chinese Communist party's Central Committee, a major meeting that typically sets out a road map for economic policies in each five-year cycle, is set to take place next week. The government had been expected to lay out a clear policy agenda and specific reforms, in addition to offering short-term stimulus to support growth. Those hopes might be dashed.

Chinese Premier Li Qiang recently spoke about dealing with the symptoms as well as root causes of the current problems. But he offered few remedies. The plenum will no doubt yield rote statements about further reform and opening up. Those will land with a thud if the government fails to reinvigorate market-oriented reforms.

The government is resisting the clamour for monetary and fiscal stimulus, for fear of creating financial risks and adding to its debt burden. To boost the economy after the pandemic, Beijing did issue a sizeable quantity of long-maturity government bonds to finance infrastructure and other spending. The central bank has eased monetary policy moderately, but credit growth remains weak. Private firms are not eager to invest in an uncertain environment.

The government has also stimulated production in selected industries — something a command economy is typically good at. Support has boosted sectors such as green energy and electric vehicles, which fits the goal of technological upgrading of manufacturing.

Getting households to consume more, when their confidence is at a low ebb and they see their homes and stock market investments falling in value, has proven a tougher proposition. The focus on large scale capital-intensive manufacturing has limited employment growth, further restraining consumption. With consumption falling behind the rise in production capacity, deflationary pressures are proving persistent. As China tries to export its way out of its problems, trade tensions with other countries are ratcheting up, adding to the gloom.

Government ambivalence towards the private sector, and outright hostility towards successful entrepreneurs, has also hurt confidence. Entrepreneurs are willing to take risks in return for the prospects of large rewards. That calculus is upended if the returns are capped, reducing private sector dynamism and damping innovation.

The banking system looks sound but is not channelling resources to the more productive parts of the economy. Banks have little incentive to lend to small and medium sized enterprises, including in the service sector. Fixing incentives, along with broader capital market development, is a major priority.

Local governments are under financial duress. They account for a large share of overall spending while the central government collects most tax revenues. This model, which was already broken, has become unsustainable as the fall in property values squeezes local government revenue from land sales. Meanwhile, the central government has added to local responsibilities, including managing the fallout from the failures of property developers.

China’s current problems are both cyclical and structural, and action is needed on multiple fronts. Stimulus is not a panacea but can be an important part of the solution. The transition from the traditional drivers of growth such as real estate investment will take time and the economy needs support during that process.

Fiscal support targeted at poorer households and measures to strengthen the social safety net would be a good start. Stimulus in the absence of a plan for broader fiscal and financial reforms, as well as steps to rebuild private business confidence, will not accomplish much, however.

China’s government seems to have a clear set of economic objectives, including rebalancing the economy towards services and higher productivity manufacturing, shifting away from real estate as a key growth driver and boosting household consumption. It now needs to articulate a concrete plan for attaining those objectives, provide a downpayment with some specific reform measures, and lubricate the process with well-targeted stimulus. Only then will the national mood lift.