Opinion **Chinese economy**

Despite abandoning zero-Covid, China's economic challenges are huge

Beijing's goal of a shift to greener high-tech industry requires a much more efficient financial system

ESWAR PRASAD

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Eswar Prasad DECEMBER 16 2022

The writer is a professor at Cornell University and senior fellow at Brookings Institution

The Chinese government's long-anticipated retreat from its zero-Covid policy briefly lifted domestic stock markets and buoyed optimism about China's short-term growth prospects. This reversal of a draconian policy was welcome news but leaves unresolved the major impediments to growth. Tackling those will take not just a policy shift but a broader reorientation of the government's approach.

The government's volte-face can be taken as a sign of flexibility or, less favourably, its dogged unwillingness to acknowledge policy errors and undertake a course correction until left with no choice. This matters as China contends with disruptions from the looming wave of infections as the economy opens up. A nationalistic approach might work well in rallying the population around certain issues but not in tackling a virus against which domestic vaccines seem less potent than foreign ones.

China's zero-Covid policy had its benefits, especially in holding down the death rate, which now looks likely to rocket. But it had major costs as well. The policy is likely to leave long-lasting scars on the economy by setting back the is likely to leave long-lasting scars on the economy by setting back the government's much-touted efforts to rebalance growth. The erratic and draconian lockdowns disrupted all types of economic activity, but hit household consumption and the services sector especially hard. Industrial activity held up reasonably well until recently but employment growth has lagged behind and the unemployment rate has risen noticeably.

China now faces harsher domestic and external environments. The real estate sector, a crucial component of household wealth and driver of economic activity, is in a slump. The government's earlier desire to cool off an overheating market and a speculative run-up in housing prices, followed by moves to ease restrictions and limit the sharp fall in prices, has only added to the uncertainty. Exporting its way out of a downturn is not a viable option as the rest of the world grapples with recessionary risks. And while the recent meeting between US president Joe Biden and Xi Jinping went well, America clearly has no intention of rolling back restrictions on technology exports that China sorely needs.

China, unlike other major economies, is experiencing low and falling inflation. The People's Bank of China has eased monetary policy and could do more. But it has been restrained by fears of financial risks and capital outflows if interest rate differentials with the US widen further. Measures to ease tax burdens and increase spending consistent with the green energy transition could also support domestic demand and facilitate growth rebalancing.

Beijing has a long-term plan to shift towards greener and high-tech industries, generate domestic innovation and become technologically self-reliant. But this will require a better financial system that directs resources to more productive parts of the economy, private enterprise that can operate without fear of arbitrary government intervention and a strong human capital base of workers proficient in new technologies.

Each of these elements has been damaged not just by policy uncertainty but by fears of a shift toward a more command-driven economy. In securing his third term as president, Xi has signalled that he will tighten control over rather than free up the country's economic and political institutions. Entrepreneurs have been put on notice that they will have to operate within tight official guardrails, which is hardly conducive to innovation.

The key challenge for Beijing is how to revive consumer and business confidence. For consumers to spend and private businesses to invest, the government needs to provide policy certainty and flexibility. These are complementary rather than contradictory. Switching between relying on market mechanisms and command-and-control policies only adds to volatility and uncertainty. With few checks and balances left in an increasingly centralised system, the willingness to acknowledge mistakes is essential.

China's government has clear and worthy objectives of delivering a substantial increase in the population's living standards and quality of life through growth rebalancing, technological upgrading and greener production. With an ageing population and an increasingly uncompetitive low-skilled manufacturing sector, achieving these aims will take more than just slogans. Xi would do well to expend some of his now substantial but dwindling political capital to show flexibility rather than ideological rigidity and permit some economic and institutional reforms.