

## China's transition: new leaders, old policies

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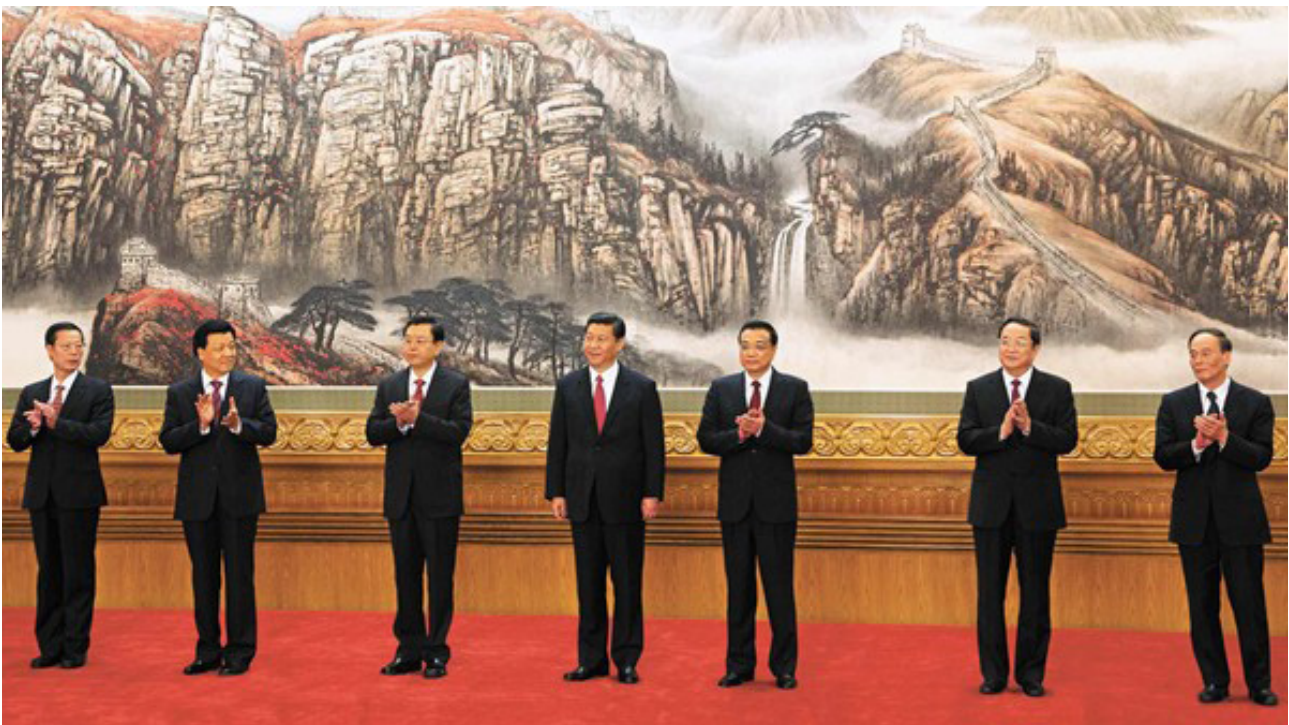
The 18th National Congress of the Communist Party of China has just finished in Beijing. Xi Jinping, 59, and Li Keqiang, 57, will take over. The debate within the leadership will continue about which way to take China: towards a full market economy open to the winds of global capital flows or to stay as they are. The view of the media and 'experts' in the West seems to be that the new seven-man (and they are all men) standing committee is broadly in favour of the status quo: don't rock the boat. If it works, don't fix it. Sure, the new leader Xi talks about getting closer to the people, bearing down on corruption, reducing inequality etc. But so do all Chinese leaders say this when they take over. There is no evidence that Xi will do any of this, or even move in any radical way towards American-style capitalism.

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*Old and new – spot the difference!* Xi's father Xi Zhongxun was a reform-minded Communist leader who was purged during the Cultural Revolution. Restored by Deng Xiaoping, he became the governor of Guangdong where he contributed to the pioneering economic reforms of Shenzhen in the 1980s. Xi has been promoted by the Shanghai faction of the Party, known for its market-driven focus, and former President Jiang Zemin. But he also rests upon the more 'conservative' faction like Hu Jintao and Communist Youth League (CYL). Xi emphasises the need for

"collective responsibility" which he defined as the absence of individual interests among the party members.

A year ago, when Beijing was pondering the 12th 5-year plan, Xi supported an acceleration of 'economic reforms', namely the new growth model presented in the "China 2030" project with the Chinese State Council and the World Bank. This report is a clear step towards an outright market economy that drastically reduces the role of the state and opens up the domestic economy to foreign capital even more. The argument of the Sinology 'experts' of mainstream economics is that only this will enable China to escape from the so-called 'middle income trap'. They mean that, to begin with, 'emerging economies' can grow fast with big capital investment and exports using cheap labour and new technology – the Chinese model.



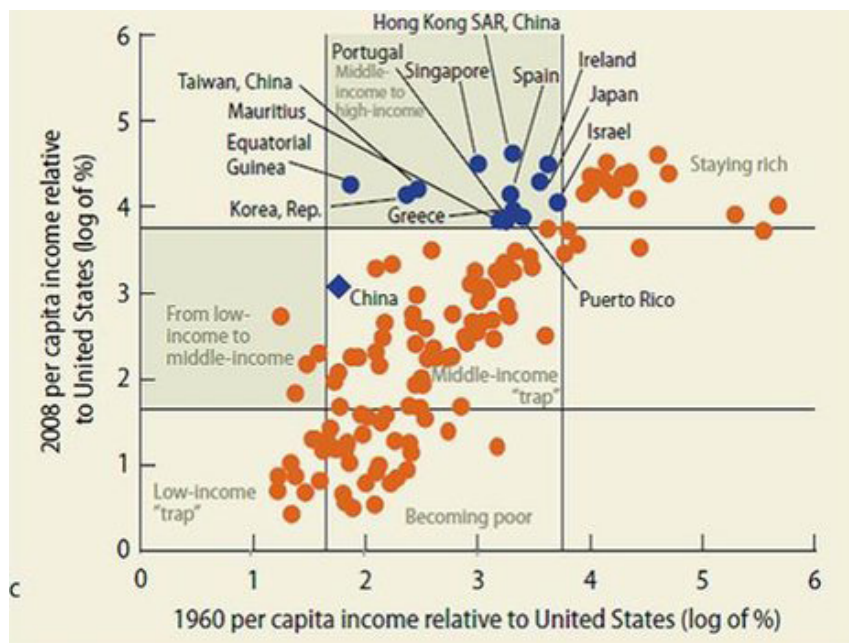


Figure 1

But less than a fifth of the 180 countries in the world have made it to being advanced economies. The chart, from the World Bank's report (see figure 1) makes the same point. Of the 101 countries that were "middle-income" in 1960, only 13 had managed to break from the pack to become advanced economies by 2008.

One reason why countries get stuck in this "middle-income trap" is that they reach what is known as the "Lewis Point", after the left economist of the 1950s, Arthur Lewis. Put simply, this is the point at which a developing country stops being able to achieve rapid growth relatively easily, by simply taking rural workers doing unproductive farm labour and putting them to work in factories and cities instead. But once this 'reserve army of labour' is exhausted, urban wages rise, incomes reach a certain level and a 'middle-class' emerges. Distorting Lewis' theory, mainstream economics asserts that then there must be a switch to boosting domestic consumption that a state-led economy cannot do. So the cry is "Liberalise with free trade and capital – that's the only way to move on". Typical of these arguments are the comments of James McGregor, author of the 2012 book *No Ancient Wisdom, No Followers: The Challenges of Authoritarian Capitalism*. He commented "China's done well in building infrastructure and getting the nation where it is but state industry is choking off

economic growth so they have to re-ignite private industry".

But the new Chinese leaders are divided on what direction to take. For example, one of the new leaders is Zhang Dejiang from Sichuan province who wants keep things as they are. For him, state-owned enterprises must strive to be "stronger, more excellent and bigger,". Under his watch, some private auto companies including Zhejiang Geonow Auto Co. were merged into state-run competitors in a process described in Chinese as "the state advances and the private sector retreats." And state-run companies still dominate. In another leader, Zhang Gaoli's city, the indebted state-owned Tianjin City Infrastructure Construction & Investment Group has projects including construction of a new financial district modeled on Manhattan. It sold a 3 billion yuan (\$481 million) one-year note in March at a 4.36 percent coupon, 220 basis points below the one-year bank lending rate at the time. By contrast, small entrepreneurs in Tianjin can get unsecured loans for 2 percent interest per month, or more than 26 percent a year, according to the 3g210.com website, which provides loan interest rate information. This is not what the Western capitalist 'experts' want to see.

And Left economist John Ross takes a different view (<http://ablog.typepad.com/key-trendsin-globalisation/2012/10/investment-will-boost-chinas-economy.html>). Raising

consumption – i.e. living standards indeed should be economic policy's aim. But unfortunately, Ross argues, this became confused with a different idea of sharply increasing the percentage of consumption in China's GDP. These two goals are actually contradictory as GDP growth is largely driven by investment, and this underpins sustainable consumption. But sharply increasing consumption's percentage in GDP cuts investment levels, thereby inadvertently leading to lower GDP and consequently lower consumption growth. This illustrates why the phrase 'consumer-led growth' is confused.

China has grown by just under 10% a year, on average, since 1980. If it can grow by at least 6% or 6.5% a year from now on, the World Bank reckons it can graduate to become a high-income country before 2030 and overtake the US as the world's largest economy. (China's income per head, of course, would still be much lower than America's.) But this is by no means guaranteed. Every developed economy has made this fundamental transition. But few, if any, have done it while continuing to increase productivity – output per head – by 6-7% a year. America, Europe and Japan had the advantage of a growing labour force for most of this stage in their development. China will not. Its population is ageing much more rapidly and its labour force will be shrinking after 2016.

How can we judge whether China will continue to grow at that sort of rate? In my earlier post, I argued that China cannot be seen as just another capitalist economy. But even so, the law of value does operate in China, mainly through foreign trade and capital inflows, as well as through domestic markets for consumption goods, services and funds. In so far as it does, profitability becomes key to investment and growth. So what has happened to China's profitability in the last 30 years? There have been various attempts to estimate the rate of profit in China. I did so in my book, *The Great Recession*, chapter 12. There are other studies that reach slightly different conclusions than I did (Zhang Yu and Zhao Feng, 2006, [www.seruc.com/bgl/paper%202006/Zhao-Zhang.pdf](http://www.seruc.com/bgl/paper%202006/Zhao-Zhang.pdf); and Mylene Gaulard, 2010, <http://gesd.free.fr/m6gaulard.pdf>).

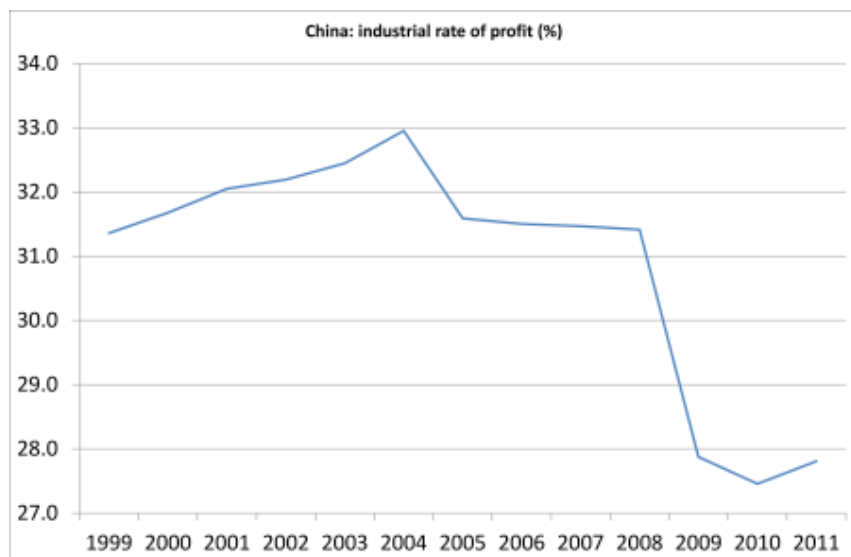


Figure 2

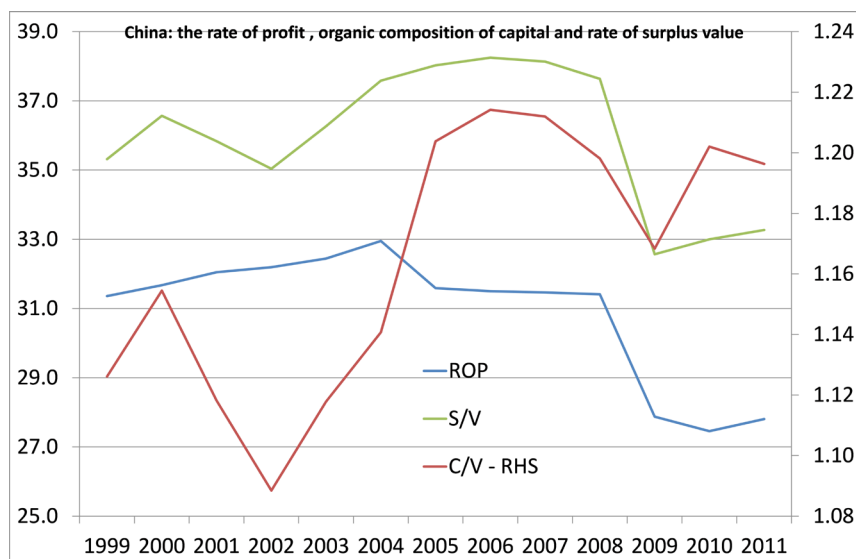


Figure 3

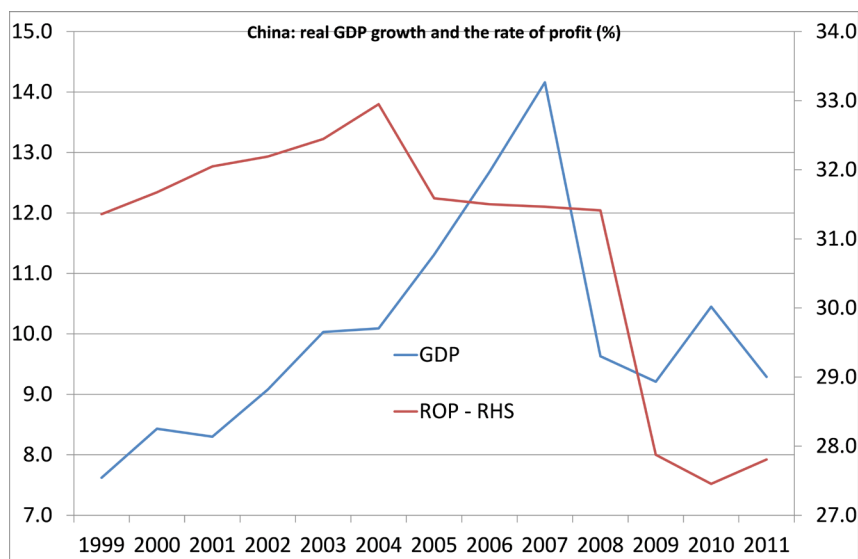


Figure 4

I found that there were three cycles of profitability. Between 1978-90, there was an upswing as capitalist production expanded through the Deng reforms and the opening up of foreign trade. But from 1990 to the end of that decade, there was a decline, as over-investment gathered pace and other economies, particularly in the emerging world went through a series of crises (Mexico 1994, Asia 1997-8, Latin America 1998-01). The falling rate of profit then was accompanied by slowing in the rate of GDP growth. Then from about 1999 onwards, there was a rise in profitability, which also saw a significant rise in the rate of China's economic growth (as the world too expanded at a credit-fuelled pace).

We are now getting better data from China to work with and I have just done further work on the Chinese rate of profit. It looks as though profitability peaked in 2004 (see figure 2).

After 2007, the slump in world capitalism drove down Chinese profitability. Rising wages were not matched by increased sales abroad, so the rate of surplus value slumped (green line) while investment in fixed capital remained high (red line). So profitability fell (see figure 3).

Inevitably, this has had a deleterious effect on GDP growth, as profits lead investment and investment leads growth, particularly in China (see figure 4).

Globalisation and the law of value in world markets feed through to the Chinese economy. And the effect has been pernicious for the majority of Chinese. Inequality of wealth and income under China's 'socialism with Chinese characteristics' has never been so bad. China's Gini coefficient, an index of income inequality, according to Sun Liping, a professor at Beijing's Tsinghua University, has risen from 0.30 in 1978 when the Communist Party began to open the economy to market force 0.46. (and see my recent post on this) China's Gini coefficient has risen more than any other Asian economy in the last two decades. The rise in inequality is partly the result of the urbanisation of the economy as rural peasants move to the cities. Urban wages in the sweatshops and factories are increasing, leaving peasant incomes behind (not that those urban wages are anything to write are

anything to write home about when workers assembling Apple i-pads are paid under \$2 an hour). But it is also partly the result of the elite controlling the levers of power and making themselves fat, while allowing some Chinese billionaires to flourish.

Is mainstream economics right to argue that people's needs and aspirations can only be met by a capitalist economy? The evidence of the Great Recession and the ensuing long depression suggests otherwise. If the capitalist road is adopted by the new leaders and the law of value becomes dominant, it will expose the Chinese people to chronic economic instability (booms and slumps), insecurity of employment and income and greater inequalities. On the other hand, if the surplus created by the Chinese people remains under the control of an elite backed by an army and police and ruling without dissent, then the needs and aspirations of a more affluent and educated population will not be met. The key to continued growth and more equality will be democracy. China needs to move from so-called 'socialism with Chinese characteristics' (i.e. a state-led economy under a corrupt autocracy) to a China with socialist foundations (democratic planning and equality). China cannot just stay as it is, whatever its new leaders might hope.