

POST-CONGRESS CHINA

A NEW ERA FOR THE COUNTRY AND FOR THE WORLD

Michel Aglietta

University Paris Nanterre, CEPII

Guo Bai

China Europe International Business School (CEIBS), Fudan University – Shanghai

China is on the right track for undertaking the ambitious reforms announced at the 19th Party Congress. Growth strengthened in 2017 amidst fiscal tightening and prudent monetary policy, though the trade war entailed temporary disturbances in late 2018. The shift from quantitative to qualitative growth in the coming “New Era” does not depend on present geopolitical uncertainties in its orientation. The long- term restructuring of the economy investigated in this article, including the project for a new paradigm of globalization by 2050, can be read without worrying too much about the vagaries of current US policy.

China is entering a new era because the main contradiction that drives development has changed. The former contradiction was the scarcity of goods and services produced in the economy, which led to poverty and required enforced industrialization to lift people out of it. Since the goal is now moderate prosperity, the main contradiction lies in the imbalances generated by past and present development.

Promoting the quality of growth aims first and foremost at reaching the technological frontier through innovation (digital economy, new energies and networks). It aims also at restructuring cities to achieve a harmonized urban/rural development and rethinking mobility. Migrants between the countryside and city should be able to retain their social rights when they move.

To fulfill the promise of prosperity in the socialist economy, the core reforms on the demand side involve centralizing social security, unifying retirement regimes and reforming the tax system to reduce the disparities between regions. Public goods must be delivered throughout the country through tax and transfer mechanisms, so that less-favored regions are not forced to resort to excessive indebtedness to provide the common goods and services to which people are entitled.

The “New Era” also has a global dimension. Recovering great power status under the full restoration of the Middle Empire for the 100th anniversary of the foundation of the People's Republic of China is an ambition to be fulfilled through restructuring the world economy, according to the mammoth project “One Belt, One Road” (OBOR). This is intended to set out a new concept of globalization.

OBOR opens opportunities to recipient countries that are infrastructure-constrained, where a lack of public goods is hindering their development. OBOR also constitutes a platform to push China's soft power across Eurasia, strengthening economic linkages through trade, capital flows and construction deals. The OBOR initiative will successfully strengthen Asian integration, since China will become the world's leading economic power before 2030. This is why the Regional Comprehensive Economic Partnership (RCEP) complements OBOR.

Keywords: New Era, Socialist Modernization, Digital Economy, Belt and Road Initiative.

*Our civilization has developed in an unbroken line
from ancient to modern times.
Xi Jinping*

Introduction: What is the new era?

In opening his report to the 19th Congress of China's Communist Party (CCP), President Xi Jinping has stressed national rejuvenation as the collective goal of the CCP to unite the people. The way to achieve this is by developing socialism with Chinese characteristics under the Party's leadership.

Chinese characteristics mean that Chinese political philosophy does not believe in an ideal order. Neither does it believe in universal values. Chinese reform is embedded in long-run history. It is global, pluralistic, and gradual, and feeds on its own contradictions. What is perennial is the unitary sovereignty of the people. The criteria for success are entirely and exclusively practical.

Taking the long view of China's modern history, one can distinguish three eras: Mao recreated the unity and independence of a poor and weak country. Industrialization was launched and pursued under terrible hardship. Deng opened the way to prosperity by accepting to awaken private interests, promoting responsibility in exchanges and opening up to the world. Xi asserts that moderate prosperity will be achieved at the conclusion of the 13th plan, on the eve of the celebration of the CCP's 100th anniversary in 2021. However, the four decades necessary to achieve this have generated an unbalanced development in multiple dimensions of social life. Furthermore, China's rejuvenation has a global dimension: recovering the power of the Middle Empire in the world community. Therefore, the new era is divided into two periods: 2020-2035, to achieve so-called socialist modernization; then

2035 to the 100th anniversary of the People's Republic of China in 2049, to reach social welfare within ecological civilization.

The goals of the directives of the 2013 third plenum of the CCP to reach a socialist market economy, which we studied in our 2014 Policy brief (no. 3, May 2014), persist. What is new is a clearer definition, a better-defined priority for qualitative growth and an evolution in two steps. Keeping in mind Xi's grand design, we will structure this article in two parts: first, *balanced growth in China for the new era*; second, *China and the world for an inclusive globalization*. The questions we ask in the first part are the following: what is socialism with Chinese characteristics? How can the Party represent the public interest? The questions we ask in the second part are: what does China want to do to contribute to a new world order? How does China collaborate with the rest of the world?

1. Balanced growth for a new era

1.1. Past achievements and present outlook

In 1997, the year of the Asian crisis, GDP per capita in China was \$782 (USD); in 2017 it was \$8200. At the 15th Party Congress, a strong government led by Premier Zhu Rongji, under the authority of CCP general secretary Jiang Zemin, took dramatic decisions to reform the economy and achieved astonishing results (Kroeber, 2017). Effective leadership was critical. In the decade 1997-2007, China's impact on the world economy was tremendous. In the years 2009-2017, the upswings in the world economy were largely driven by Chinese demand. Since 2013, under Xi Jinping, China's government has managed the slowdown of the economy, curbed corruption and enhanced soft power abroad.

Pessimists about China, flourishing in the Western establishment and media, have always been wrong in their dire predictions since the Tiananmen events of 1989. They are unable to understand that the mix of State capitalism, managed markets and authoritarian rule is a recipe for a long-term view, hence for breaking the tragedy of horizons, while Western democracies, chiefly in Europe, have floundered for a long while in a mix of economic stagnation, slowing productivity, low productive investment and political discontent.

Since the 1970s, most people in the West have been indoctrinated in a neo-liberal ideology that equates a market economy with a liberal

political regime. However, this is not what reasonable economic theory teaches. Market efficiency demands that private property rights are secured and that innovation can thrive. These conditions are realized in China. There are simultaneously a very large private sector, a rising middle class and a widespread innovative spirit in the civil society. The middle class wants political stability, good governance and secure property rights. The Party's legitimacy rests on attention to public goods. This is why the new era will be emphasizing qualitative growth. Therefore, what is critical is effective leadership that provides a long-term developmental view and a competent public administration. A dynamic economy is compatible with China's authoritarian regime, as it is with competent democratic regimes, both empirically and theoretically. The economic problems arise when the political regime fails.

What Western critics invariably underrate is that China's central authorities command a high degree of respect and support within the country. The large consensus stems from the ability of the development-oriented State to modernize, while ensuring political and macroeconomic stability. As pointed out by Zhang Weiwei, this means of governance originates from the Confucian tradition of a strong, benevolent State, supported by a meritocracy at every level of administration. In economic matters, the guiding philosophy has nothing to do with any normative model of optimal equilibrium; it is "seeking truth from facts". Chinese characteristics in the development process mean a rejection of shock therapy and the adoption of a pragmatic, trial-and-error approach that puts people's livelihood first. This has led to an unprecedented accomplishment: a socialist market economy (Zhang, 2018).

As we pointed out in our previous policy brief on the 13th five-year plan, Western scholars have totally misread the meaning of China's unbalanced growth in the 1997-2017 period. Unbalanced growth has been the trajectory of the Asian regime of industrialization, followed earlier by Japan, Korea and Taiwan. Unbalanced growth reflects successful industrialization. Sustained high investment was necessary to shift hundreds of millions of workers from rural labor-intensive activities to industrial capital-intensive activities. The decline of consumption/GDP from 45% to 37% between 2000 and 2015 was not an impediment but the condition for achieving a continuous increase in per capita consumption over 20 years, and doing this much faster than any other major country.

The initial economic conditions are favorable for the post-Congress reforms. Growth strengthened in 2017 to 6.9% from 6.7% in 2016, benefiting from a widespread recovery in the world economy; hence, growth was achieved amongst fiscal tightening and prudent monetary policy. Consumption expenditures confirmed that they have become the leading growth factor, with a contribution of 4.1% out of the 6.9% GDP growth against 2.2% for investment and 0.6% for net exports¹. Even so, private investment grew by 6.0% in 2017 against 4.2% in 2016. The higher-than-expected GDP growth gives maneuver to rein in any rise in debt/GDP in order to maintain financial stability along a steady growth path.

Profits improved markedly in 2017, with a reduction in overcapacity and price supports. Property prices calmed down in major cities, with liquidity tightening and macro-prudential measures. Therefore, the government can safely consider slower growth in coming years under tighter regulation and deleveraging (Herrero, 2017). The average forecast of the international institutions is 6.5% GDP growth in 2018 and 6.3% in 2019, largely enough to achieve the goal set in 2011 of doubling the average real income per capita between 2010 and 2020². Indeed, to achieve that target, an average 5% growth rate between 2018 and 2020 would be enough. Lower capital growth and a flat labor supply curve to 2030 leave total factor productivity (TFP) as the main driver of growth. This represents the shift to qualitative growth on the supply side in the coming “New Era”.

The fundamental reorientation of the reform implies “the strengthening of the Communist Party's comprehensive leadership”. This is why the Party's Congress has been accompanied by institutional reform. The objective is to transform the overall political governance from “sector management”, a remnant of the planned economy, to “function management”, to better coordinate separate ministries towards the goal of socialist modernization.

1.2. New Era: Achieving socialist modernization by 2035

According to Xi's report to the 19th Congress, China is entering a new era because the main contradiction that drives development has changed. The former contradiction was the scarcity of goods and

1. *BBVA Outlook, first quarter 2018.*

2. Service économique régional du Trésor à Pékin (2017), *Bulletin de Statistiques Économiques*, 4^e trimestre.

services produced in the economy, which led to poverty and required enforced industrialization to lift people out of it. Since the goal is moderate prosperity, the main contradiction lies in the imbalances generated by past and present development. Therefore, citizens' wellbeing will be the principle guiding socialist modernization up to 2035. Supply-side reforms are the means to achieve this in the economic sphere.

From March 5th to March 15th 2018, the National People's Congress (NPC) held its annual session, preceded by the meeting of the Chinese People's Political Consultative Conference (CPPCC) on March 3rd. On March 5th Premier Li Keqiang presented the Government's annual working report. He announced a 6.5% growth target for 2018, equal to the average forecast of international institutions, an inflation target of 3% and a fiscal deficit of 2.6%, with a more conservative target of 3.7% in 2017. The authorities will be likely to set a range of targets between 6 and 6.5% until the end of the 13th plan, because this will be a transition period to help local governments adapt to the new era that emphasizes growth quality. This was confirmed for 2019 at this year's session of the NPC. The targets will be adjusted so that the People's Bank of China (PBoC) can maintain its prudent monetary policy stance to facilitate the deleveraging of the financial and corporate sectors. Specific measures will be taken to facilitate credit to private firms in 2019.

Until 2035-40, the "affluent class", meaning incomes equal to or over \$20,000, is expected to triple from 100 to 300 million people. Gradual achievement through supply-side policies means keeping TFP-driven growth at 5% until 2025, then a steady slowdown to 4% around 2035. Therefore, the crucial question is the ability to spur innovation in a stable macroeconomic set-up, so that TFP becomes the main factor driving growth.

The myth that "China can't innovate" is one of the perennial Western prejudices. However, indigenous innovation has been spurred since the 2006 Science and Technology Plan, and it was then given priority in the 2013 industrial policy initiative known as "Made in China 2025". China's overriding advantage is its huge domestic market and the high competitive pressure to achieve economies of scale at home before venturing overseas, like Japan in the 1960s and 1970s. State support and financial availability are strong complementary inputs.

In macroeconomic terms, using a naïve Cobb-Douglas production function, the shift from investment-driven to consumption-led growth

means that the Investment/GDP ratio adjusts from 45.7% in 2015 to 36.8% in 2025 and 33% in 2035. Growth in the capital stock will decline steadily from 9.5% in 2015 to 4% in 2035. Under a constant structural unemployment rate and a moderate increase in the participation rate, the trend in labor growth will be about flat from 2020 to 2030, then decreases at an 0.2% annual rate between 2030 and 2035. Under these assumptions, potential GDP growth could reach 5% in 2025 and 4% in 2035. With this scenario and the assumption that the US will grow optimistically at 2.5% to 2035, the two economies will reach a similar size (Jinyue *et al.*, 2018).

The assumption for TFP growth in this tentative scenario is conservative. The upgrading process of the productive structure based upon the deployment of the digital economy might justify a higher TFP growth. The potential to improve over the long run is great with Fintech, IT, e-commerce, high-speed railways and new energy all making up the strategic industries prioritized in the 2025 industrial policy objective.

TFP growth could also come from improvements in corporate governance in State-Owned Enterprises through SOE reform to eliminate inefficient firms and correct the misallocation of capital and labor in the economy. Above-normal productivity growth might increase potential GDP growth by one percentage point up to 2025.

Therefore, promoting the quality of growth aims primarily at reaching the technological frontier through innovation (digital economy, new energies and networks). It aims also at restructuring cities to achieve a harmonized urban/rural development and rethinking mobility. Migrants between countryside and cities should be able to retain their social rights.

To achieve its promise of prosperity in the socialist economy, the core reform on the demand side involves centralizing social security, unifying retirement regimes and reforming the tax system to reduce the disparities between regions. Public goods must be delivered throughout the country through tax and transfer mechanisms, so that less-favored regions are not forced to resort to excessive indebtedness to provide the common goods and services that people are entitled to use.

Democratic legitimacy with Chinese characteristics is expressed by what the Party has achieved for the people. The question of political legitimacy is less, "what are the formal rights that define a democratic regime?", and more, "what has been done with power?". Democracy is inseparable from inclusiveness since, according to Rawls, what

counts are the real conditions of liberty and that poverty means a deprivation of liberty. Therefore, respecting the law implies a relentless fight against corruption.

1.3. Digital economy: The fulcrum of a new growth regime

Innovation has spread at an astonishing speed in the last few years. Indeed the top three Internet companies in the world are American (Google, Amazon and Facebook). However, Alibaba is fourth and Tencent is fifth. Moreover, each of the two countries has five of the top 10 Internet firms. According to the Boston Consulting Group, amongst the 221 unicorns³ existing in the world, 29% are already Chinese⁴. Chinese unicorns are catching up fast because startups there take four years to attain unicorn status, whereas American ones take seven years. The combined market capitalization of American unicorns is still larger. The US has 112 unicorns while China has 63 for the time being. However, if growth in China, both in number and market capitalization, carries on for some time, their market capitalization would soon overtake their US counterparts.

What are the driving forces in the outstanding development of China's high tech industry that will make it China the leading global force in the digital era? Indeed, China is not only expanding its own market at an amazing speed. It is also shaping the global landscape and inspiring entrepreneurship in investing worldwide in digital technologies, creating a virtuous circle because it is also the world's leading adopter (McKinsey, 2017). This momentum is triggering an intense creative destruction process on a larger scale in China for two reasons. First the digital industries draw advantage from the inefficiencies of traditional industries; second the potential for commercialization is massive because consumer demand for digitalization is so intense. The interactive dynamic between supply and demand contributes to the increase in TFP.

According to McKinsey's researchers, there are three moving forces: the rapid commercialization of business models on the demand side, thanks to the large and young consumer market; the broad digital ecosystem on the supply side, which is much wider than the digital giants are; and government backing as an investor and consumer of

3. A Unicorn is a start-up whose assets are valued at 1 billion dollars or over.

4. Boston Consulting Group report, *Fast and Furious: Chinese unicorns to overtake American counterparts*, September 18, 2017, drawn up in collaboration with the research divisions of Alibaba, Baidu and Didi.

digital technologies. Therefore, China is generating waves of digital innovations and entrepreneurial activities. The BAT (Baidu, Alibaba, Tencent) have been building a digital ecosystem that extends far beyond their own individual ambit. Alipay and We Chat offer super-apps that give consumers broad coverage of services and social interactions.

In 2006, China accounted for less than 1% of the value of world-wide transactions in e-commerce; in 2016, it was 40%. Overall, there were 731 million Internet users against 343 million in the EU and 262 million in the US. The penetration of mobile payments has been tremendous. 68% of Chinese Internet users make mobile payments against 15% in the US.

On the supply side, China's venture capital is focused on digital investment. It has increased from \$ 12bn (6% of world total) in 2011-2013 to \$77bn (19% of world total) in 2014-16. The main types of investments are big data, artificial intelligence and Fintech.

Going deeper into the interactions that link production processes to consumer demand, the research gathered in the McKinsey report exhibits three processes: *disintermediation*, *disaggregation* and *dematerialization*.

For instance, in providing mobility, disintermediation enables carmakers to reach consumers directly, while disaggregation lowers the demand for new car sales by substituting shared mobility devices. In health care provision, disintermediation helps address chronic diseases via the Internet of Things and artificial intelligence. Disaggregation can dramatically reduce health care expenditures by making diagnoses using big data and 3-D printing. In freight and logistics, disintermediation can address industry fragmentation between small truck companies with real-time matching platforms, while disaggregation can enable flexible capacity through crowd-funding delivery. Finally, dematerialization changes processes and products from physical to virtual, enabling consumers to get products that can be dematerialized anywhere at any time.

In China, government policies are giving a big boost to the digital economy in implementing the 2025 industrial China plan. The government is creating a market for frontier technologies in robotics and artificial intelligence by backing long-term investment in innovative companies and by expanding the infrastructure of the digital ecosystem. The government is also promoting competition to fuel

innovation through lowering entry barriers for new firms. Finally, and most importantly, the government has the duty to manage labor markets during the digital disruption up to 2030-2035. The shocks are manageable, because the long view of a stable government makes it possible to develop an effective program to smooth the transition as much as possible. The government must support lifelong learning and reform education to help people acquire the right skills. It must also improve job-deployment programs to enhance labor mobility.

1.4. Sustainable growth: Matching the digital economy and the energy transition

Energy geopolitics has long been dominated by the fight against scarcity, since oil and gas are not available everywhere. The US has long maintained its hegemony, in alliance with the feudal powers in the Middle East. The oncoming imperative energy transition towards a low-carbon energy system worldwide is a most powerful force, which will transform the capitalist growth model. As Francis O'Sullivan (MIT Energy Initiative) claims, "we are moving from a world where the value of the energy is embedded in the resource to another where technology is the resource". Getting rid of the rentiers for a better world is what Keynes advocated long ago. China is aiming to lead this revolution to contribute to a new world energy order.

Building an ecological civilization by mid-century is a goal asserted by the 19th Party Congress. China's growing middle class is demanding a cleaner environment anyway. Moreover, the costs of industrialization have been huge. They are strong evidence of the "imbalances" (Hsu, 2017). 1.5 million deaths a year in China are attributed to air and water pollution. 116 cities have fine-particulate concentrations over five times the safe level set by the World Health Organization (WHO). GHG emissions in China tripled between 2000 and 2014. The Environmental Performance Index (EPI) ranked China 109th out of 180 countries in 2016.

So there is a long way to go. A new book on the geopolitics of renewables argues that the main constraint will shift from scarcity to variability, so that Grid Politics will replace Pipeline Politics (Scholten, 2018). China is firmly committed to clean energy and has already generated an impressive array of clean-energy entrepreneurs. The boost from the State through subsidies, policy targets and manufacturing incentives paid out \$132bn in 2017 alone according to the Bloomberg New Energy Finance agency. This was more than the US

and EU combined. The International Energy Agency (IEA) reports that China has built a third of the world's wind power and a quarter of its solar capacity, and that it has sold more electric vehicles than the rest of the world (IEA, 2017).

This effort, guided by government plans established from 2013 to 2016 to reduce air, soil and water pollution, has made real improvements. These plans amount to the world's largest environmental cleanup effort.

However, the contradiction between economic and environmental goals has not been solved yet. It is what post-Congress policies are expected to achieve in the long run. And this is what green development as a linchpin of the quality of growth is all about. The hypothesis is that "Going Green" in new products, technologies and investments to decouple from GHG emissions and environmental damages is itself a source of growth.

The macroeconomic reform implemented in the 13th 5-year Plan has already reduced the energy intensity of growth. The official target in the Plan is a reduction of 40 to 45% from the 2005 level by 2020. This is crucial for boosting productivity and abating air pollution by lowering energy demand per unit of GDP. Moving away from coal as an energy source is key for environmental sustainability in both GHG emissions and local air pollutants. The change in energy mix will stimulate the development of innovative growth industries. In primary energy, the objective for the share of non-fossil fuel is 15% by 2020 and 30% by 2030, up from 10% in 2013.

China's target is for absolute emissions to peak in 2030 at the latest. What remains uncertain is the peaking level, the actual peaking year and the post-peak trajectory. Drawing on an in-depth study by the New Climate Economy (NCE) of the Global Commission on the Economy and Climate (GCEC), Fergus Green and Nicolas Stern are optimistic (Green and Stern, 2015).

The NCE built and compared two scenarios: continued vs. accelerated emissions reduction. Both scenarios assumed the same average GDP growth rate: 7.3% in 2010-2020 and 4.8% in 2020-2030. Table 1 summarizes the results.

According to the UNFCCC (United Nations Framework Convention on Climate Change), a reasonable global benchmark for 2030 would be 35GtCO₂eq. If China's emissions are at 14Gt, it will still take 40% of the world carbon space. Green and Stern point out that

12 GTCO₂eq should be an upper limit for China in 2030, and a target of 10 would better avoid the risk of a rise in average temperature substantially above 2°C in the 2nd half of the century. In that case the emissions peak will be reached earlier than 2030 at a level lower than projected in the NCE study.

In pursuing the energy transition at a lightning speed, China has been able to produce more of its own energy and reduce its reliance on fuel imports. Furthermore, in developing clean-energy technologies, China is providing an impetus to inclusive and sustainable economic growth for the New Normal. Indeed, to eradicate poverty entirely and to go on increasing real wages fast, productivity gains must be found in high value-added, innovation-intensive sectors. Handling environment damage and fighting climate change resolutely is one best way to do it. This can be done by combining three approaches: transforming traditional sectors with energy-efficient investments; expanding energy-green industries with renewable energy investments; and developing services via restructuring urbanization to create smart cities.

Table 1. Comparing continued/accelerated scenarios

Variables	2010	Continued reduction		Accelerated reduction	
		2020	2030	2020	2030
Total energy consumption (bns tons of ≈ coal)	3.25	4.92	6.25	4.75	5.90
Energy intensity of GDP (2010=100)	100	73.4	54.6	70.6	51.6
CO ² emissions from energy (GT)	7.25	10.4	12.7	9.68	10.6
Proportion of non-fossil energy (%)	8.6	14.5	20	15	23
Total GHG emissions(GT CO ₂ eq)	9.4	13.5	16.5	12.6	13.8

Source: GCEC (2014), Table 4.4, p.82. Results assume growth averaging 7.31% in 2010-2020 and 4.77% in 2020-2030. They are based on the NCE China study: "Middle Economic Growth Scenario".

How will it be possible to achieve rapid emissions reductions post-peak? City and energy reforms must be concerted in mixing clean innovations, green financing and fiscal reform.

In cities, urban planning is crucial for the long-term path-dependency it creates. City planning must be based on compact models of urbanization, with cities linked in a modular system by high-speed railways supporting mass transit and a range of interconnected means of local mobility. Changing commuters' transport system behavior on the demand side and electrification of the transport system on the supply side have a high potential to abate GHG emissions. Road transport will

also be overhauled, combining electric, hybrid and fuel cell vehicles using low-carbon biofuel. This can make huge differences in local pollution. Urban planning requires reforms to city-level fiscal and governance arrangements.

As for energy efficiency, work remains to be done. To displace coal usage, non-coal primary sources will be scaled up. Gas and hydroelectricity will be developed in the medium term, while other renewables and nuclear power will be expanded at an accelerating pace. Gas will be used in the medium term in many activities to replace coal. It will be mainly supplied from Russia and Central Asia through pipelines. Nonetheless, under the imperative of energy security, shale gas can take the lead in the medium term as a substitute for coal and a backup of renewables.

Most important will be managing between variable and non-variable energy sources in the grid system. Furthermore, the opportunity of storage in the future will come from lower cost batteries linked to large-scale expansion of electric vehicles. This is where digital devices will be most useful. China's leap forward in digital technologies will make renewable energy storage and distribution more competitive.

1.5. Inequalities and inclusiveness in China

An advanced team commissioned by the UN was gathered to compare the income distribution in China, in advanced countries and in other regions of the world from 1980 onwards (Alvaredo *et al.*, 2017). The measure of inequality is presented as the income share of the top 10% of earners (Figure 1) and of the bottom of 50% earners (Figure 2). On both measures, inequality in China in later years is higher than in Europe but much less than anywhere else in the world, including the US and Canada. In 2016, the top 10% of earners captured 37% of national income in Europe, 41% in China, 46% in Russia, and 47% in the US and Canada. It reached 54% in sub-Saharan Africa, 55% in Brazil and India and an extravagant 61% in the Middle East. The profile in Russia is very interesting. Until the breakdown of the USSR, it was by far the least unequal country in the world, followed by China. Then the share of the top 10% of earners jumped incredibly, doubling from 25 to 50% of GDP from 1992 to the Russian crisis of 1998 in the Yeltsin era, when the oligarchs carved up state property like vultures. In reinstating State authority, Putin turned downwards and then stabilized the inequality curve, albeit at an elevated level.

Measured by the share of the top 10% of earners, inequality in China increased substantially from 1998 to 2006, levelled off from 2006 to 2012, and then has declined slightly with the catching-up of the minimum wage decided in the 12th five-year plan starting in 2010 and with the fast rise in average wages in the 12th and 13th plans.

As pointed out above, an emerging middle class in China is rising. The recent rate of wage growth has been high, and social benefits have improved. Increased wages should result in consumer demand for better services. It should also lift the prices of non-traded and traded goods, raising the profit margin of firms in the services and consumer goods sectors. This might in turn generate demand for labor to substitute for the reduction in production capacity in oversized industrial sectors.

There is no surprise that the bottom 50% of earners in Figure 2 shows inverted profiles compared to Figure 1. However, both curves can be misleading if the overall growth performance of the economy and that of different income groups in terms of real income growth is not taken into account. Table 2 shows the widening gap in income structures as well as their growth over 1980-2016.

The table underlines China's impressive performance. It was already mentioned that the rise of inequalities in China was mainly linked to the forceful industrialization process. Central planning and a gradual process of modernization controlled it. The contrast to the big bang in Russia is startling. There the instant opening to the market economy exploded the State and destroyed all public institutions in the 1990s. As a result, the bottom 50% of the population was crushed entirely. Even after 20 years of reestablishing the verticality of State power from 1998 onwards, their real income per capita has fallen 26% over the last 36 years.

In China, the real income of the bottom 50% of the population has increased 417% over this same period, from the reform launched by Deng Xiaoping and pursued in continuity thereafter. Only Western ideologists and politicians pretend that China is not democratic. This view is untenable if the criterion of legitimacy is: "what has been done with public power?". China has moved from a poor, low-income country to the world's leading emerging economy. Could it have done this with an autocratic repressive power?

The rising inequality has been largely due to the urban-rural divide. In China's urban areas, the adult population grew from 100 million in 1978 to almost 600 million in 2015. During this same period, the adult

rural population remained roughly stable. The income gap between urban and rural China has been increasing over time. Urban households earned twice as much income on average as rural households in 1978, but in 2015 they earned 3.5 times as much (Piketty, *et al.* 2017). This is why coordinated urban-rural development has become a principle of qualitative growth in the new era to reduce the gap, which appears among regions because the process of industrialization has been unequal over the huge territory of the nation

Figure 1. Top 10% income shares across the world (1980–2016)



Figure 2. Bottom 50% income share (1980-2016)

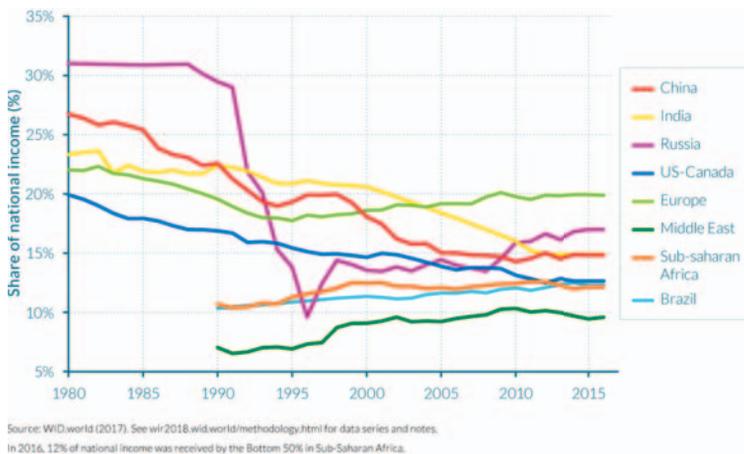


Table 2. Global income growth and inequality (1980-2016)

Total cumulative real growth per adult %

Income group	China	Europe	India	Russia	US-Canada	World
Full population	831	40	223	34	63	60
Bottom 50%	417	26	107	-26	5	94
Middle 40%	785	34	112	5	44	43
Top 10%	1316	58	469	190	123	70
Top 1%	1920	72	857	686	206	101

Source: WID World 2017.

Joint development refers to the strategy of creating or strengthening economic axes to narrow the gaps between regions. The importance of the “Go West” strategy to upgrade China's Western regions has a straight link with the “One Belt One Road” priority in international development. Western regions will benefit from high-speed railways and thrive on processing agricultural products, encouraging cultural tourism and focusing on environmental protection. Central areas have the advantage that they are at the junction of the vertical and horizontal axes of communication. They are building clusters for advanced manufacturing and high-tech industries.

The other pillar for improving inclusiveness, beyond a continuous increase in real primary income, is the improvement in social benefits demanded by the expanding middle class. This includes improving health and education on the one hand, and overhauling social welfare on the other hand.

Modernizing and improving education to increase capabilities is a top priority for innovation-led growth. To achieve integrated urban-rural development, the Plan has set a target of 95% of child enrollment in compulsory education, which will require inclusive pre-school education in rural areas. The educational framework emphasizes vocational education and a major effort to create a modern university system in order to promote higher quality employment to reduce the income gap at the primary level.

A drastic reform of the system of health and medical care is under way with the following orientations: separating hospitals and medicines; prohibiting hospitals from making a profit on the sale of medicines; granting legal status to public hospitals; and increasing their subsidization. Medical costs must be controlled so that health insurance is affordable and the insurance fund sustainable. Health insurance coverage should reach at least 95% of the rural and urban

population by 2020. To guide those sweeping reforms, a National Health Committee has been established, highlighting the paramount importance that the political leadership gives to the problem of ageing.

Reform of the social security system is the cornerstone of an inclusive society. Nowadays the system is a hodgepodge of disparate regimes for both retirement and health. The levels of contributions and benefits vary widely from one individual to another and are fragmented geographically. The consequence of this fragmentation is a lack of transferability of risks and rights. Overall, expenditure on health accounts for too much of household budgets and leaves rural retirees and migrants in a precarious situation.

President Xi has reasserted the objective of universal health care coverage. To achieve this, financial mechanisms need to be improved, moderate levels of guarantees provided and administrative responsibilities assigned to administrative levels compatible with the available financial resources. To ensure the portability of social rights, the system must become more centralized, with responsibilities shifting to central government. The system also must adjust to the ageing population to improve benefits, while remaining sustainable. The social security fund will be strengthened by funding transferred from the dividends paid by SOEs to the government as a shareholder.

The main axis of reform addresses population ageing. The retirement age will be extended gradually, with activity in old age encouraged, and women's involvement in the labor force increased, especially in high-skilled jobs.

1.6. Deleveraging and overhauling the financial system

In mid-July 2017, China's highest authorities held an important meeting, the 5th national financial work conference (Umehara, 2017). This conference established the Financial Stability and Development Committee of the State Council to strengthen the financial supervisory system. The PBoC's risk management power was reinforced to prevent the occurrence of systemic financial risk. The new Committee has been assigned the role of enhancing cooperative actions between the PBoC and the financial regulators of the banking (CBRC), insurance (CIRC) and securities (CSRC) markets. Furthermore, the CBRC and the CIRC have merged to crack down on regulatory arbitrage between the banking and insurance sectors. Indeed, the dangerous expansion of shadow banking was largely due to the inconsistency of the guidelines between the regulators, inconsistencies that have fostered regulatory

arbitrage, itself generating complexity and opacity that impedes the ability to measure asset quality.

In its latest assessment of the stability of China's financial system, the IMF has provided a sober view of the risks and improvements lately achieved (IMF, 2017). The general symptom of financial vulnerability is the rise in credit intensity, e.g. the amount of credit needed to generate one more unit of GDP. It has risen steadily, contributing to the large credit gap measured by the overall credit/GDP ratio over its long-run trend. This gap has reached 25%, which points to significant distress remaining in the financial system from two intertwined processes: credit flows to unprofitable enterprises and obscure financial engineering driven by the proliferation of shadow banking. Vulnerabilities have been mounting in declining industries, generating overcapacities, and in the real estate sector.

Nonetheless, the financial system has a certain amount of robustness. Chinese households are little indebted relatively to their accumulated saving. Chinese economic agents have very little foreign debt. Furthermore, growth resilience allows room for the authorities to engineer deleveraging. China is not on a razor's edge. Corporate debt is high at 250% of GDP, much higher than in emerging market economies, but equivalent to the US and close to the UK (270%) and Korea (230%) and, of course, much less than Japan (350%). The authorities have taken steps to address the vulnerabilities and curb shadow banking.

Deleveraging is imperative for the debt-laden corporate sector anyway. It has been triggered in the private sector by the reduction of fixed asset investment (FAI) in unprofitable industries. This has been underway since 2016 in sectors with the lowest capacity of utilization (coal mining, iron and steel, cement, and other industries transforming primary commodities). It is still robust in the automobile, machinery and equipment, and public utility sectors.

For SOEs, the government is seeking to withdraw the implicit guarantees and clean up zombie firms. For large-size SOEs, the method is forcing M&As and injecting equity capital while introducing new investors to develop mixed ownership and improvement in governance. However, this will not be enough. Curbing shadow banking will be crucial to containing SOEs' leverage, because shadow banking has become an important channel for funding zombie SOEs.

Shadow banking is extensive and complex. To circumvent regulation, it has created a large array of financial instruments: wealth management products, trust company products, entrusted loans,

bankers' acceptances, private lending, microfinance loans, trust beneficiary rights, etc. These activities are bank-centric to channel funds from depositors into off-balance sheet product issuances whose proceeds can be channeled into the capital markets and back to the real sectors.

Because asset quality in shadow banking is problematic and because it is intertwined with the banking system, shadow banking is a source of contagion risk. Because formal financial institutions cannot identify risk sources, the opacity of shadow banking makes it difficult to manage counterparty risks. Attempts to curb shadow banking via credit tightening in 2013 were unsuccessful, because they clashed with the pressure to meet growth targets. Concerted regulatory efforts are needed to close the loopholes and discrepancies in regulation.

It is the role of the new high-level financial regulatory committee established in 2017 to eliminate the financial vulnerabilities transmitted by shadow banking. The combination of monetary prudence and concerted regulatory efforts has started to bear fruit (Jinyue *et al.* 2017). Trust loans, entrusted loans and bank acceptances have significantly slowed. New issuance of interbank CDs to finance the shadow-banking activities of small banks has shrunk. Impulse response functions indicate that one standard-deviation shock on M2 or total social financing leads to a 0.3% impact on GDP growth. Therefore, one can presume that the tightening of current regulations will have a limited downward impact on growth.

2. China and the world for an inclusive globalization

China's leadership aims at recovering great power status under the full restoration of the Middle Empire for the 100th anniversary of the foundation of the People's Republic of China. The ambition is to restructure the world economy according to the mammoth project "One Belt, One Road" (OBOR).

The announcement of the project in the fall of 2013 represents a shift in China's attitude to world politics from Deng's era, when a low profile in international matters was advocated. In 2014 already, the OECD report "*Shifting Wealth*" pointed out that globalization is entering a new stage, driven by the redeployment of emerging market economies' growth onto their domestic markets. In Asia, this new momentum will integrate the area with the support of massive infrastructure investment. Meanwhile, the US-led financial market-driven brand of capitalism will meet serious obstacles, due to the intrinsic

inability of markets to finance global public goods like the climate, energy security, and ecosystem disruption. This means that global catching-up in following Western-style past capitalism is a dead-end.

More recently, Trump's presidency amounts to the destruction by the US of the world order it designed after World War II to secure its benevolent hegemony. From trade to climate, the US has repudiated the international agreements it contributed to promote and lately has moved to outright protectionism. By contrast, in later years China's State Council has taken initiative to organize a web of trade and financial links in the emerging and developing world, based upon the international financial institutions led by China: the BRIC's bank, the Silk Road Bank and the Asian Infrastructure Investment Bank (AIIB).

However, China does not want to overthrow the principle of an open multilateral economy, but to work within this principle. Let us understand how China's financial opening and the move to currency convertibility is managed before assessing the promises of OBOR, since both are matched in the perspective of building a new multilateral world order.

2.1. Managing financial opening and currency convertibility

Since the 2013 Directives, financial reform in its international dimension has aimed to promote the Yuan to the status of an international currency by 2020. The government has already been successful in its push to introduce the Yuan in the SDR basket. The logical consequence is decoupling from the dollar.

The grand design behind the move is the future transformation of the international monetary system (IMS) into a multilateral system whose architecture would be based on institutionalized monetary coordination under the auspices of a reformed IMF on the one hand, and the upgrading of the SDR as the ultimate reserve asset on the other hand. Under this framework, the IMF would become the international lender of last resort, the quota system would be abolished, and the issuance of SDRs would become endogenous to countercyclical needs in managing the global financial cycle. With an international lender of last resort that is both equitable and open to all countries, the saving that is wasted by many countries in accumulating large amounts of dollar reserves for self-insurance would be reallocated to productive investments.

Such an evolution in the international monetary system is perceived as the monetary basis of a transformation in global finance with public development banks as prominent financiers. According to energy and

climate experts, the world should invest \$90trn in infrastructure for sustainable development, mostly in developing countries (Stern, 2015) over the next 15 years. The challenge is high because of the colossal lack of infrastructure despite huge amounts of saving. Therefore, the world financial system needs to be overhauled (UNCTAD, 2015). Notably, the capacity of public development banks to invest in infrastructure must be massively increased.

As widely observed, financing long-term infrastructure projects involves risks that market finance does not handle. Infrastructure finance requires capital immobilizations during long periods, which entail large upfront costs along sequential stages in the process of investing. Those risks are plagued with gross underestimates, which make them difficult to insure. Moreover, the reason for those investments is to produce positive externalities in the economy. Hence, their social return is higher than their private financial return. This is why those investments are under-produced in the logic of market finance.

Public development banks are prominent financial actors to fund large-scale and long maturity projects, which generate positive externalities. They have the mandate to back up such projects. Their capital is owned by financially credible sovereign entities, both national and international. Subsequently they can borrow long on international bond markets at low costs.

Development banks enter the governance of investment projects because they are expert in selecting, evaluating and monitoring complex projects. They are natural partners in the choice of the techniques, amounts and localization of infrastructure investments. They can attract other lenders and lever their resources. Their unique characteristics make them the core intermediaries of an alternative model of global finance (Table 3).

In emerging market countries, the rise to prominence of development banks, linked to central banks, will become a driver of sustainable development. In taking a multilateral dimension, development banks can finance infrastructure projects that integrate whole regions of the world, if they can overcome the pitfalls of coordination. One such candidate is the Asian International Infrastructure Bank (AIIB), with public shareholders in more than 40 countries. However, it is essentially inter-Asian, with 75% of its capital held by countries in Asia. Other candidates are the Silk Road banks. The national development banks can also play a countercyclical role in preserving financially vulnerable developing countries from external shocks, and they can back the natural internationalization of the Chinese currency decoupled from

the dollar. Correlatively, China has a foreign policy advocating the evolution of the international monetary system to multilateralism. Because a system of competing currencies without a commonly accepted international liquidity is unstable, campaigning for a reform of the IMS, whereby the SDR would realize its potential as ultimate international liquidity, is a strategy worth pursuing. Meanwhile China's government must decide how it proceeds to convertibility, so as to accommodate the long-run objective of a new pattern of globalization and the challenge of the transition.

Table 3. Two models of financial globalization

Washington consensus + US\$ key currency	Integration via infrastructure finance +SDR multilateral currency
Key concept: market efficiency	Key concept: systemic resiliency
<ul style="list-style-type: none"> – Financialization of the firms (shareholder value) – Globalization by capital flows linking all asset markets worldwide via arbitrage and speculation – Intermediation by market making under the dominance of investment banks – Internl LOLR by Fed's swap network – Developing countries forced to accumulate \$ reserve as self-insurance 	<ul style="list-style-type: none"> – Stakeholder firms as going concerns – Globalization by global public goods and >0 externalities. Finance structured by LT invests – Intermediation by development banks (national and multilateral) – Internl LOLR by IMF's SDR account – Collective insurance releases saving for productive investment
Major shortcoming: inability to finance real LT investments	Major shortcoming: risk of political conflicts in selecting, monitoring and exploiting investment projects

In doing this, Chinese monetary authorities are confronting a well-known problem in international monetary economics when choosing a currency regime. This is the famous Mundell's dilemma⁵. The first best would be compatibility between fixed exchange rates, inducing stability in capital markets, free capital flows, inducing a presumed efficiency in the allocation of world saving, and full autonomy in national monetary policy so as to pursue relevant domestic objectives.

As these three objectives are incompatible in a world of competing sovereign nations, one of them must be abandoned. Countries could negotiate compromises, and there would be a regime of institutionalized coordination like the Bretton Woods system that essentially accepted capital controls, fixed and infrequently acceptable exchange rates, and autonomy in monetary policy. After the Jamaica Accord of 1976, all common rules have disappeared. When China instituted a single exchange rate and created a central bank to run a unified mone-

5. Mundell's impossibility theorem is set out in his book *International Economics*, Mac Millan (1968).

tary policy in 1994, the government chose a strict peg on the dollar up to July 2005. Afterwards the government inaugurated a crawling peg, although returning to the fixed peg during the financial crisis. Capital controls remained an essential pillar until the new leadership stated the objective of financial opening. Then Mundell's dilemma came back with full force.

The long-run solution is clear. China's ambition requires both free capital flows and independent monetary policy. Therefore, a flexible exchange rate regime is the logical consequence, as soon as broad, deep and resilient domestic capital markets have been established and tested. In the meantime, a mix of capital controls should be retained, together with a managed exchange rate regime against a currency basket to maximize the autonomy of monetary policy. Nonetheless, both market participants and observers must understand the stance of monetary policy. This is not merely a question of transparency. It is so the monetary authorities can persuade the market that they know how to solve the dilemma on their own and that the decisions of monetary policy, confronting the many shocks that arise in everyday life, are compatible with the stance that has been chosen.

2.2. OBOR in a new multilateral world order

OBOR couples a belt that will be linking China to Europe on the ground through Central Asia with a maritime route from China to the Mediterranean countries. The goal is to create a platform of economic cooperation between Asia, Africa and Europe. OBOR intends to represent a new concept of globalization (Table 3). In contrast to the Wall Street model, entirely built upon the domination of finance, OBOR claims multiple forms of interrelationships: political collaboration, infrastructure interconnections, mutual trade, long-term capital flows and mutual understanding between peoples. It hopes to contribute to solving the problems that plague the international community: unequal development, rivalries in political governance and inability to handle the deterioration of common goods.

The OBOR initiative provides an overarching framework for China to achieve its economic and strategic goals (Miller, 2017). Announced by President Xi Jinping in November 2013 at the third plenum of the CPC, OBOR is an integral part of the new era. Its development will cover the entire period between 2013 and 2050 in three phases: mobilization (2013-2016), planning (2016-2021), and implementation (2021-2049) (Deorukhkar and Le Xia, 2017). OBOR brings infrastructure, a

new trade route and better connectivity between China and Europe. A Belt and Road forum took place in Beijing in May 2017; 30 heads of State attended the forum along with representatives of 100 countries and 70 international organizations (S.E. Zhai, 2017). The countries of Southeast and Central Asia were heavily represented. In his address to that conference, President Xi urged delegations to reject protectionism and embrace the new China-driven concept of globalization, which is more inclusive and more equitable in providing mutual benefits.

OBOR opens opportunities to recipient countries that are infrastructure-constrained, where a lack of public goods is hindering their development. OBOR also constitutes the right platform to push China's soft power across Eurasia, with strengthening economic linkages through trade, capital flows and construction deals. The Asian Development Bank (ADB) estimates that OBOR countries need to invest \$22.6tn in infrastructure from 2016 to 2030 (\$1.6tn yearly) in electricity generation, transport and telecoms to drive up growth. Conversely, long-term investments generate potential growth for sustaining future debt-servicing capability.

Apart from infrastructure investment, Chinese digital companies are exhibiting increasing interest in investing in OBOR regions as well. These investment and economic activities can help those regions to leapfrog their developmental stages and potentially embrace a greener trajectory of development as well.

OBOR funding is reliant on China-based institutions (80% of the total in the mobilization phase until 2016) and an array of multilateral financial institutions (AIIB, Silk Road Fund, New Development Bank for BRICS, ADB and World Bank). OBOR provides an opportunity to internationalize the renminbi as a vehicle currency in cross-border trade settlements and in local currency swap agreements. As a financing currency, it can rely on Hong Kong, which will become a major financing hub for OBOR.

The OBOR initiative will successfully strengthen Asian integration, since China will become the world's leading economic power by 2030. This is why the Regional Comprehensive Economic Partnership (RCEP) complements OBOR. The negotiation of the RCEP has been boosted by Trump's rebuke of the Trans-Pacific Partnership (TPP). The RCEP will be an economic partnership agreement covering the 10 ASEAN countries plus six other countries (China, India, Korea, Japan, Australia and New Zealand). The agreement on tariffs is a work in progress that is due to be completed and signed in November 2018. The RCEP plus OBOR

make a formidable tool to retaliate against US protectionism. Aggressive US actions will strengthen China's leadership in Asia, while the rebound effect of protectionist actions against China will hurt US interests, given the high level of US investment in China. By eliminating trade tariffs within regional supply chains, the RCEP will help regional manufacturing for a more compact regional industrial structure.

3. Conclusion: China and the world

In 1950, China was by far the poorest country in the world, with GDP per capita only 4.6% of the US level according to Maddison (OECD). In 1990, this had risen to 6.7%, after which the catching-up has been outstanding: 12.8% in 2000 and close to 25% in 2015. China is well on its way to socialist modernization.

The transformation of China's economy over the next 20 years will change the pattern of globalization, which will take a new course under the imperative challenge of inclusive and sustainable growth. In Asia, this new momentum will integrate the area with the support of massive infrastructure investment. Meanwhile the US-led, financial market-driven brand of capitalism will meet serious obstacles due to the intrinsic inability of markets to finance global public goods, like the climate, energy security, and ecosystem disruption. 21st century capitalism will not create sustainable growth regimes without socio-political innovations from multiple regions of the world. To achieve sustainable growth, the global financial system must be transformed in the direction of long-term financing.

China's assertiveness in world markets and world politics stems from this huge incipient regime change. China does not want to overthrow the principle of an open multilateral economy, but to work to improve it with its own characteristics. China's collective leadership wants to restore the historical central role of the Chinese Empire in Asia. Therefore, they want the country to be entirely reunited.

China is more than a nation-state. A millenary civilization has created the institutions of a unitary imperial state. China has no desire and no need for global hegemony, because its founding culture does not pretend to embody universal values. With the rest of the world, China wants to develop economic, financial, technological and cultural relationships and cooperate politically to secure the global public goods on which our common security depends.

References

- Aglietta, M., and G. Bai. 2012. *China's development: Capitalism and empire*. Routledge.
- Aglietta, M. G. and Bai. 2014. "China's roadmap to harmonious society." *CEPII Policy Brief*, (3), May.
- Alvaredo, F., L. Chancel, T. Piketty, E. Saez, and G. Zucman. 2017. "Global Inequality Report." *WID.world Working Paper Series*, (2017-20).
- Dcorukhkar, S. and Le Xia. 2017. "China one belt, one road: Progress and prospects." *China Economic Watch*, BBVA Research, November.
- Garcia, Herrero A. 2017. "A stellar global economy in 2018." *Natixis Beyond Banking*, December.
- Green, F. and N. Stern. 2015. "China's new normal: Structural change, better growth and peak emissions." *Policy Brief*, University of Leeds and LSE, June.
- Hsu, A. 2017. "The environmental horizon: Still murky." *China Economic Quarterly Review*, 21(4): December.
- IMF Country Report. 2017. *People's Republic of China: Financial System Stability Assessment*. (17-358), December.
- International Energy Agency. 2017. *World Energy Outlook: China*. November 14th.
- Jinyue Dong, B. Huang, and Le Xia. 2017. "Taming China's Shadow Banking Sector." BBVA Research, August.
- Jinyue, D., A. Ortiz, and Le Xia. 2018. "China from miracle to great moderation: Potential GDP estimation of China." BBVA research, *China Economic Watch*, January.
- Kroeber, A. 2017. "A good few decades, but not a Chinese century." *China Economic Quarterly*, 21(4), December.
- McKinsey Global Institute report. 2017. "Digital China: Powering the economy to global competitiveness." December.
- Miller, T., 2017. "Belt and Road to Leadership." *China Economic Quarterly Review*, 21 (2): 9-16, June.
- Scholten, D. ed. 2018. *The Geopolitics of Renewables*. Springer.
- Stern, N. 2015. "Keeping the climate-finance promise." Grantham Research Institute on Climate Change, LSE, November.
- Umehara, N. 2017. "Overview of the 5th National Financial Work Conference: China seeks for financial stability and development." *Newsletter of the Institute for International Monetary Affairs*, (15).
- UNCTAD. 2015. "Long-Term International Finance for Development: challenges and possibilities." *2015 Report*, chap. VI, pp.153-179.
- Zhai (S.E.), J. 2017. *L'avenir des relations franco-chinoises*. Institut Diderot, Les Carnets des Dialogues du Matin, June.
- Zhang, W. 2018. "How China made it." *The Economist*, March, (10-16).