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A Window on China's New Normal
March 27, 2015

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CAMBRIDGE – Every year at this time, China's government organizes a major conference – sponsored by the Development Research Center, the official think tank of the State Council – that brings together senior Chinese officials, CEOs from major Chinese and Western firms, and a small group of international officials and academics. The China Development Forum (CDF) occurs just after the annual National People's Congress.

At the forum, speakers, including the finance minister and the head of the central bank, summarize the Chinese leadership's current thinking. Officials then listen to comments and suggestions from Western business and academic participants, including a question and answer session with Premier Li Keqiang.

Although I have been attending the CDF's meetings for more than a decade, I found this year's conference substantially different from any in the past. The key difference was the official Chinese recognition that annual real GDP growth has declined permanently from the past three decades' average rate of nearly 10%. The official estimate is that real GDP grew 7.4% in 2014, and that the rate will probably slow further, to 7%, this year. The Development Research Center presented detailed estimates showing that the growth rate will continue to decline, reaching about 6% by the end of the decade.

Virtually every Chinese official referred to this slowdown as their country's "new normal." They all seemed reconciled to slower growth, which was initially surprising, because officials previously argued that China needed rapid growth to maintain employment and avoid political unrest. They now appear to understand that the declining growth rate will not lead to unemployment, because the slowdown reflects China's structural shift from export-oriented heavy industrial production to increased production of consumer services, which require more employment to create the same amount of value.

Stronger growth nevertheless remains necessary, because China is still a relatively low-income country with substantial poverty. Although China's total real GDP is second only to that of the United States (and might be larger when measured in terms of purchasing power), its per capita income is only about $7,000, or roughly 15% of the US level. And consumption remains low – only about 50% of GDP when government spending is included, and just 35% when limited to household consumer spending. So China has a long way to go to reach its leaders' goal of achieving a "modern prosperous society."

The Chinese see that the "new normal" requires a shift in their growth strategy from factor-driven growth to innovation-driven growth. But it is not clear how that increase in innovation will be achieved. While officials stress reliance on the market, China does not have the venture capital and "angel financing" that facilitates innovation in the US. The authorities may hope that their plan to insure bank deposits will shift deposits from the three largest banks to many smaller banks around the country, facilitating local startups' access to financing.

Many other economic problems loom. Officials acknowledged at the CDF that the biggest risks lie in the financial sector, particularly owing to local governments' very large liabilities. In the past, the government dealt with the problems that these liabilities caused for the banking system by injecting funds into the banks. Environmental problems are another powerful drag on China's current standard of living. But they also represent a potential way to increase GDP should overall demand decline significantly. China acknowledges that high levels of air and water pollution create discomfort and harm the public's health. Government spending on remedying environmental damage could absorb substantial funds if demand-side weakness exacerbates the expected supply-side slowdown.

Moreover, the very weak performance of state-owned enterprises, which continue to play a large role in heavy industry and in some service sectors, represents a powerful brake on growth. Although official policy aims to reduce these firms' role so that "the market can play the decisive role in resource allocation," shrinking these firms has proved to be difficult, owing to their strong political backing within the Chinese Communist Party.

At the same time, China maintains restrictions on direct investment by foreigners, limiting both the kinds of firms and the share of joint ventures that they can own. The official policy is to reduce the barriers to foreign corporate investment, especially in high tech and the service sector.

There were, of course, a number of subjects that remained just below the surface and were not discussed at this year's CDF.

There was no indication of a slowdown in President Xi Jinping's anti-corruption campaign, though some private conversations suggested that the campaign has resulted in decision-making delays that are hurting productivity and growth.

There was also no discussion of Chinese cyber theft of Western technology. When that subject was raised in 2014, Li denied that the Chinese do such a thing, but noted that Chinese firms are hacked by domestic sources. And, with the CDF's emphasis on cooperation, there was no discussion of possible military action by the Chinese to stake their disputed territorial claims in the East and South China Seas.

Meetings like the CDF provide a useful window into a country whose importance for the global economy will continue to grow. The current slowdown to a new normal makes such windows even more important.

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