

CHINA'S DEVELOPMENT RIDDLE: NAVIGATING UNCERTAINTY WITH THE CMBP T.NOTE SERIES

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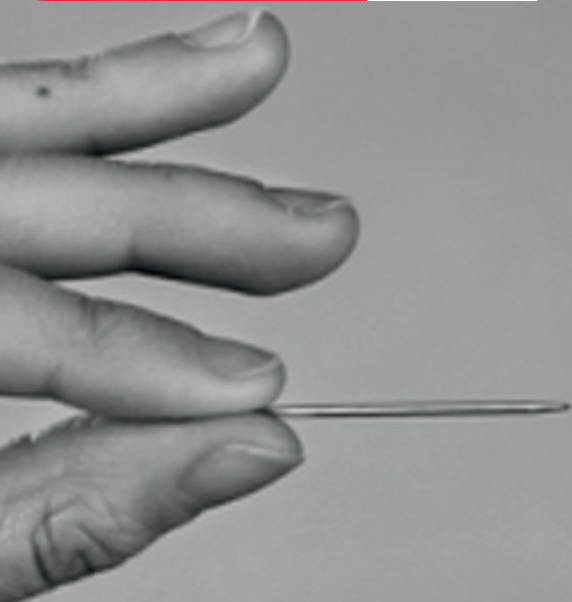
Never has living in China, working with China and watching it develop been more challenging and interesting than today. The sheer number, size and complexity of the contradictions, distortions and conflicts pervading the world's second largest economy have ballooned since the 2008 world financial crisis and the trend is expected to continue in the near future. No single domain in China's economic, political and legal systems is either shielded or safe. China's economic and financial system is the paramount example: a slew of doomsday-calling articles appeared on the international press in recent months pointing out how the uncontrolled raise of debt, the slowdown in GDP growth or the large-scale layoffs in heavy industries could be signs of an imminent end of the Chinese miracle. While some of those claims could be overstated, it is undeniable that the Chinese economy is under severe stress already, even though we are still in the early days of the transition to the new development model promoted by the Chinese leadership. Having finally admitted that the export-led and production-intensive economic model was no longer sustainable, Zhongnanhai has decided to move past the rhetoric of the

previous decade and take concrete action to modernise the economy and change current paradigms. It was clear that such a shift would be problematic and the road to be taken very bumpy (the euphemistic expression "New Normal" being an evident attempt by the official story-telling machine to sugar-coat the pill) but the reality is exceeding expectations.

The above-mentioned contradictions, distortions, and conflicts must thus be placed in the context of the current transition phase of the Chinese economy. Under the new economic model, according to the official line at least, the private sector should play a stronger role; however, as confirmed by several publicly available data, the policies in place continue to favour state-owned enterprises and the public sector in general. A modern service-economy should replace the manufacturing sector as the engine of the domestic economy; however, to boost the GDP, the government continues to pour large amounts of money in infrastructure spending and the direct and indirect subsidization of heavy industries. The financial sector should be more open and interconnected, but the grip of central authorities over all segments of China's debt and capital markets continue to be suffocating. There is almost no single economic data supporting the thesis of the stalling contradictoriness of the current development stage

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of China and the necessity of a fundamental change of the existing paradigms: in 2015 alone, China registered USD 1 trillion in capital outflows despite the tightening of capital controls, a 15.2% growth of non-financial debt, 300 new infrastructure projects worth more than USD 1.5 trillion approved, a 7-year low in factory activity, an unprecedented number of layoffs and strikes.

Contradictions are not limited to the economic system however: in the legal field, the reform process provides for a strengthening of the legal and judicial system but the reality shows most of the problems affecting the Chinese legal system (e.g., incomplete rule of law system, poor quality of legislative drafting, tight control of the judicial system, red tape) remaining unchanged, or have in fact worsened. Over the past few months, Chinese rule-makers moved into reverse gear by passing a number of restrictive and authoritarian laws and policy measures in a variety of fields including capital markets (e.g., measures granting wide powers to market regulators adopted as a countermeasure to the stock-market turmoil occurred in June 2015), criminal procedure (e.g., a vaguely drafted antiterrorism law granting more discretionary powers to police and armed forces), cyber-security (e.g., an equally vaguely and ideologically worded framework law potentially foreign companies doing business in China on matters such as data storage and treatment). The situation is similar in other domains such as politics, education, science and society at large. Innovation is a paradigmatic example, combining many of such domains: while not a day goes by without Chinese media and authorities reiterating their commitment to the promotion of innovation, the environmental conditions (e.g., educational system, constrained private sector, limits to the access to information) remain largely hostile to the growth of the “seeds of innovation” which are otherwise present everywhere throughout the country.

It would be a mistake, however, to confine the contradictions, distortions and conflicts to the State vs. society dichotomy: similar dynamics are also taking place within parts of the political apparatus, industries, geographical areas, demographic segments, social classes and so on; with each of these categories adding further complexity to an already fractured scenario.

The history of China is paved with contradictions and apparent absurdities; but the impression of many China observers, including the author, is that their number and significance has now reached an unprecedented and probably unsustainable level.

In what may seem as a prophecy, Minxin Pei had anticipated more than ten years ago the current state of affairs:

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While most China observers agree on the critical moment of China’s development path, strong divergences exist as to the possible outcomes of what Minxin Pei iconically defined as “China’s trapped transition”. Answers such as an economic downturn, social disorder or political clashes are scenarios that cannot be excluded with certainty but they appear extremely simplistic. The range of possible scenarios covers a 360° and three-dimensional spectrum. China will probably continue to dismiss the predictions based on existing models and set new standards while it pursues its own, unprecedented development path.

Some possible trends of such path can however be detected: this special series of T.notes will be devoted to the analysis of the most salient among such trends, exploring the contradictions, potential for conflict and – indeed – opportunities intrinsic to China’s current development trajectory. These T.notes are developed as part of the ChinaMed Business Program, T.wai’s signature training facility for young leaders from the Euro-Mediterranean region developed at Peking University in partnership with the University of Torino and ESCP Europe Business School. In line with the pragmatic and business-focused approach of the ChinaMed Business Program, this series of T.notes – rather than relying on the dubious (whenever dealing with China) official data, abstract reasoning and theoretical considerations – will leverage on the practical experience of the author and empirical observations made on the ground.

Few – if any – areas of the world are set to benefit more from China’s continued stability and change of development paradigm. It is therefore essential that current and future decision makers and entrepreneurs treading along the fabled “21st century Silk roads” engage with policy-informed and practical conversations on the systemic problems facing China, the envisaged solutions, and the likely scenarios, including the potential winners and losers, both in China and abroad.

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