Opinion

FROM THE CAPITAL

When the China party is over

Time for China, and the rest of the world, to confront the future

John Robertson

Chinese premier Li Keqiang… development 'the key to solving every problem we face'

All investors these days, not least those exposed to minerals and energy, have a vested interest in the longevity of the Chinese communist party.

Despite their political lineage, today's Chinese leaders are talking like any democratically elected leader in the West about the impediments confronting their efforts to sustain growth. In this respect, alternative systems of governance are converging.

In his government work report to the 12th National People's Congress on March 5, Chinese premier Li Keqiang put development front and centre as "the key to solving every problem we face", but there was no glossing over the difficulties. His candid address to 3,000 assembled comrades sounded much like any other leader battling the headwinds of reform fatigue.

The 15,700-word English translation of the two hour address released by the State Council of The People's Republic of China offers some of the best evidence that China is slowing because swathes of comrades are not ready to embrace the necessary changes.

Li's concession that growth of "approximately 7%" would be targeted gained the headlines, although the slippage from 7.5% should not have come as any surprise. The maths in favour of a slowdown had long been compelling. Forcing the share of investment spending lower after it had already nudged 50% of GDP – while still aiming for GDP growth of at least 7.5% – required the rest of the economy to be moving at an impossibly high breakneck speed.

For consumption to grow fast enough to meet the higher targets, wages would have had to rise at a hyperinflation-threatening pace that would have caused a slump in national competitiveness and, most likely, social upheaval. The 7% growth target "takes into consideration what is needed and what is possible", according to the pragmatic premier.

How much below 7% still qualifies as "approximately" will start to take up more thinking time in financial markets. This and the timing of the first US interest rate rises are set to be the preoccupying financial topics in 2015.

In flagging the change of pace, premier Li did not display great confidence about the likelihood of achieving the lower target, describing stable growth as "becoming more difficult" and leaving open the chance of falling short "without deepening reform and making economic structural adjustments".

The premier's speech highlighted a commitment, at least on his part, to the greater use of market forces to achieve policy ends. "Routine services that can be provided by a third party should be handed over to the market or society," he said. The government's need "to find the right balance between managing debt and maintaining steady growth" echoes what leaders of all advanced economies are saying.

China must rely on a more explicitly service-oriented economy "as resource-related and environmental constraints grow and costs for labour and other factors of production rise", Li warned. Significantly for the links between China and many commodity exporting countries like Australia and Canada, China's government is conceding that "a model of development that draws on high levels of investment and energy consumption and is heavily driven by quantitative expansion becomes difficult to sustain".

The numbers will still sound big enough to fool some. The premier said there would be another 8,000km of railway track opened in 2015, approximately the same as in 2014. But the flip side of even impressively steady, big numbers is no growth.

Despite similarities with their western counterparts, Li and communist party chief Xi Jinping have more to lose than popularly elected leaders if they fail to keep their constituents happy. According to David Shambaugh, a professor of international affairs and the director of the China policy programme at George Washington University, "the end-game of Chinese communist rule has now begun". The highly regarded China-watcher argued in the *Wall Street Journal* on 6 March that, behind a façade of stability, the system is unravelling.

The idea that China is inexorably moving away from communist rule is neither new nor surprising. After all, the centrally planned model has failed everywhere else and China has already transformed itself into a unique blend of markets and central authority.

Critically, financial markets appear to be thinking of this evolution happening over decades or, at least, not daring to think of the alternatives. Shambaugh sees the timing as more immediate. He raises the possibility that Xi Jinping himself will be deposed in a coup d'état. On Shambaugh's reading of the situation, Xi is creating dangerous enemies as he leads the effort to root out corruption and challenges vested interests to keep growth purring at the rates he needs to retain power.

For the past 20 years or more, rising living standards in China have made a loosening of the communist party's grip on daily life more palatable for the ideologically inclined. Improved living standards and less centralised economic decision-making have also opened opportunities for those with a more entrepreneurial bent. Especially when they had strong connections to pre-existing centres of power, some have acquired great wealth. A confluence of interests has helped drive economic success.

While most outside North Korea would applaud the prospect of a new giant liberal democracy, there can be no guarantees about which way the dice will fall. A new China political paradigm might prove less Jeffersonian and more Putinesque in complexion.

For all of its growing similarities with the West, China remains different in this important respect. A failure to meet near-term growth objectives will not simply mean an election, a change of governing party, a regrouping around marginally changed policies and the re-engineering of a cyclical recovery.

A Chinese failure to meet its objectives contains far more ominous geopolitical and financial market overtones as well as, more mundanely, the prospect of less iron ore or copper being used. ▼

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