

China buckles up for the Third Party Plenum

8 November 2013

This weekend China will arguably see the most important political conference in ten years as the Communist Party gathers in the Third Plenum of the 18th Central Committee. By talking of a “master plan” President Xi has raised expectations that the upcoming meeting will bear a set of unprecedented broad and deep reforms. The outcome, however, will almost certainly prove much less spectacular. Most of the recipes to fix China’s unbalanced growth story have been proposed numerous times before and some of them will be repeated again at the forthcoming Plenum. This time is probably not very different in that respect. Yet, the event is important. The key thing to watch will be whether the new leadership will be able to send a clear and coherent message about where it wants the country to head in the years ahead.

This weekend’s meeting is a plenary session of the Central Committee which is selected every five years. The current group is the 18th in place. The Committee meets once each year, except in the first year of each five-year cycle, when there are two meetings (there was one in February). Thus, with last November’s meeting counted as the first, this is the third Plenary Session of the 18th Central Committee. Traditionally, third plenums have focused on economic issues. Since 1978 they have been the launching pad for many of China’s major reforms. Hence, the importance of this conference especially after the new leaders (President Xi and Premier Li) took office in March.

Following three months of improving economic activity the timing of the conference is favourable. That said, growth is still overly dependent on investment while the low share of income that goes to households restrains consumption. Chinese leaders have long been aware that this is not a healthy situation. Already in 2007, former Prime Minister Wen Jiabao called the Chinese economy increasingly unstable, unbalanced, uncoordinated and ultimately unsustainable. Importantly, in the wake of the “Great Recession” the situation only got worse. Moreover, this evolution was accompanied by a sharp rise in credit growth. Chinese policymakers awaits the very challenging task of clearly explaining how they will address the current unsustainable situation. Last week the State Council Development Research Centre (the country’s top think-tank) already threw some light on what we can expect from this weekend. It is highly likely that the rhetoric of Chinese leaders will go pretty much in the same direction. This means that the new policy framework is likely to stress the importance of fiscal reforms, financial reforms, land and social reforms. In short, measures that have all been suggested several times before.

It is important to keep in mind that this weekend’s Party Plenum is a conference where Chinese leaders will set the direction and outline general principles. Major changes in actual policy should not be expected anytime soon and reforms will only be implemented gradually. For example, the liberalisation of the financial sector or power restriction of state-owned enterprises in order to increase market efficiency will not come overnight. That is because the former would not be welcome and too risky from an economic point of view whereas the latter would face significant resistance of vested interests. This, however, does not reduce the importance of the event as it will be interesting to see if Chinese leaders can come up with a clear and coherent framework that addresses the present unbalance. That said, the theoretical exercise may still be the easy part. In practice, changing the underlying drivers of the economy in a way that leaves economic growth near current high levels is likely to prove much more difficult. Chinese leaders have stated before that annual growth of 7.2% is needed to reach the objective of doubling living standards by 2020. But it is difficult to see how this objective can be reconciled with a significant shift away from investment towards consumption. Such a shift is likely to go hand in hand with gradually slower growth.

