The economy

No storm, but lots of tea cups

WUHAN

The newly empowered president is not using his authority to push for reform

IDEOLOGICAL flexibility has long been critical to success in China. The office of a state-owned company in Wuhan, a big central city, testifies to its enduring importance. On the bookshelf behind a senior manager's desk are a few red-bound Communist Party tracts, including a collection of speeches from a recent meeting where "Xi Jinping Thought" was written into the constitution. Stacked alongside these is literature of a different breed: two analyses of blockchains, a primer on the "industrial revolution 4.0" and a recently published guide to life and business by Ray Dalio, an American hedge-fund billionaire.

The manager sees no contradiction. Like many of his peers, he is as fluent talking about the business models of semiconductor-makers as he is reciting Mr Xi's contributions to socialism with Chinese characteristics. Yet the latter has, over the past few years, taken up more and more time. One staff member says they must regularly gather in study groups to pore over Mr Xi's words and write essays of self-criticism, identifying their failings as party members and state employees. It is, she says, "quite a headache", though she insists that the firm's business has not suffered as a result.

There has been a marked shift in Chinese politics under Mr Xi as he has placed more emphasis on the power of the Communist Party, and on his own power within the party. For the economy, as for the Wuhan state-owned company, there has been little downside so far; growth has remained strong. But the test may soon get stiffer. On March 11th the National People's Congress (NPC), China's rubber-stamp legislature, is due to vote on a proposed amendment to the constitution to abolish the two-term limit on a president's tenure, paving the way for Mr Xi to stay in office indefinitely. This shift will carry implications for every aspect of policy-making, including the management of the economy.

The optimistic view is that the change might in fact help the Chinese economy, at least in the short run. "We have stability and clarity," says Zhu Ning, an economist with Tsinghua University. Mr Xi has amassed enough clout to push through reforms that have hitherto proved tricky. He has presided, for example, over the closure of many loss-making coal mines and steel mills over the past two years, which has helped restore what remains of those two industries to health, albeit at the cost of some 2m jobs.

The apparent certainty that Mr Xi will be the country's leader for, at a minimum, another decade should also give officials and enterprises confidence to make longer-term plans. This, in turn, might improve the chances of success for two of his pet projects: the Belt and Road Initiative—a scheme to invest vast sums in infrastructure across Asia—and Xiong'an, a new city being built near Beijing.

Others predict a much bleaker outcome. They worry that Mr Xi's elevation will make governing China less, not more, efficient. Local officials may fall in line with national policy more readily than in the past, but an excess of zeal could be more damaging than a shortage, says Yanmei Xie, an analyst with Gavekal Dragonomics, a research firm. A case in point was the environmental campaign which left thousands of residents of Hebei, a northern province, without heating at the start of winter, after local officials choked off coal supplies to meet pollution targets.

Over time the risks will become more severe. With Mr Xi unassailable, it will take a very brave bureaucrat to dissent from his ▸▸

script. And as the economy grows ever more complex, the inadequacies of the institutions that underpin it, especially the rule of law, will become more glaring.

Both optimists and pessimists have been scrutinising the current session of the NPC, which began on March 5th, for clues about Mr Xi's intentions. Alas, they have found little evidence for the idea that an empowered president will clear the way for deep economic reform. The most important titbit so far has been the unveiling of this year's target for economic growth. It was contained in the "work report" that Li Keqiang, the prime minister, presented to the NPC's 2,970 members amid the cavernous pomp of the Great Hall of the People in Beijing.

The government will aim for growth of "around 6.5%", as it did last year. But Mr Li omitted last year's pledge that it would strive for higher growth if possible. Some analysts argued that this constituted a slackening of the authorities' push for growth at all costs. But it would have been much bolder for Mr Li to abandon a precise growth target altogether, as the IMF had urged.

Still, there were plenty of positive messages. The government dropped its growth target for fixed-asset investment and lowered its projected fiscal deficit, a signal to officials to rein in excessive spending. Mr Li included a new target, for the surveyed urban unemployment rate, which he pledged to keep below 5.5%. That could help sharpen the government's focus on the welfare of citizens. Mr Li also said that spending on social security, education and health care will rise, even as investment in infrastructure falls.

Yet these various policies, welcome though they are, are tweaks to the existing economic system, not dramatic or difficult reforms. They are the kinds of initiatives that the Chinese civil service has proved itself more than capable of delivering in recent years, without intervention from an overwhelmingly powerful president.

It is possible that, when Mr Xi's team is fully in place, his agenda will become more ambitious. Liu He, Mr Xi's most trusted economic adviser, is expected to be made vice-premier, responsible for economic and financial affairs. He has promised that reforms will "exceed the international community's expectations". But the focus for now is on asserting party control. On March 17th the legislature will vote on a plan to shrink the number of state agencies and put them more firmly under party leadership, according to *Bloomberg*, a news agency. As part of that restructuring, the banking and insurance regulators are expected to be merged, as are the agency that oversees industrial companies and the product-quality watchdog, among others.

Mr Xi's influence over the proceedings was felt in other, more disturbing ways. The work report mentioned his name 13 times, the most references to any living leader since Mao Zedong. When the constitutional amendment to scrap the presidential term limit was read aloud in Great Hall, the crowd greeted it with boisterous applause. The banner headline on the website of Xinhua, China's official news agency, on the day of the work report was about Mr Xi's meeting with delegates from Inner Mongolia, followed by four more stories about his recent speeches and schedule. It was only the sixth article that covered the work report and the various economic targets for 2018. They are being overshadowed by the biggest target of all: enhancing Mr Xi's power. ■

Trade

A steamroller in reverse

HONG KONG

The country's share of global and Asian exports has peaked

CHINA's exporters once had little to offer the world and everything to learn from it. In the 1960s intrepid entrepreneurs ventured across the border from Hong Kong to the Canton Fair to buy wooden toys from China's rudimentary factories. One visitor threw away a sock in his hotel, according to the book "Toy Town" by Sarah Monks. It was later mailed back to him, darned and washed.

In 1978 when the country began to reform and open up, it accounted for less than 1% of global exports of goods. For the next 37 years, its share grew remorselessly, accelerating around the time of its entry into the World Trade Organisation in 2001. In socks, for example, China accounts for about 40% of world exports.

But in 2016 something unusual happened. China's share of global merchandise exports slipped: from 13.9% to 13.5%, according to IMF data. That might have been a blip in a tumultuous year. But in the first 11 months of 2017 (the latest data available) its share fell again, to less than 13%.

Jugger-not

Exports of goods, % of Asian total

12-month moving average

Sources: Oxford Economics; CEIC

The story is similar within Asia, points out Louis Kuijs of Oxford Economics, a forecasting firm. China's share of the region's exports has dropped by 2.6 percentage points from 2015 to 2017 (see chart). Currency fluctuations are one potential culprit. But although the value of the yuan, weighted by trade and adjusted for inflation, rose until 2015, it weakened for the next year and a half.

It is also tempting to place the blame wholly on deteriorating demographics and rising labour costs. But although China's working-age population is shrinking, its labour force, and urban employment, is still growing.

Besides, China is losing market share not only to cheaper, younger countries like Vietnam. It is also ceding ground to greyer, costlier rivals like Japan, South Korea and Taiwan. The trio's combined share of Asia's exports rose by almost 1.2 percentage points from 2015 to 2017.

Exporters in these three developed economies have benefited from a powerful upswing in demand for sophisticated electronic components, such as flash memory chips—an industrial niche that China has yet to commandeer for itself. But the price of some of these technological delicacies has recently begun to fall. Are these countries' gains therefore merely cyclical? The present tech cycle may indeed be losing momentum, argues Mr Kuijs, but the three countries are still well placed to gain from the long-term growth of artificial intelligence and robotics.

China's economy meanwhile has evolved from industry towards services, which are harder to sell across borders and which are anyway excluded from merchandise-trade statistics (which cover only goods). China's domestic spending has also risen faster than production, resulting in a narrower trade surplus. Some of the goods China would once have sold to foreigners it now consumes itself.

China's exports have also become more Chinese. Fifteen years ago they had a big hole in them: only 55% of their value was added in China, according to a broad measure of the "processing trade" compiled by Mr Kuijs. Most of the remainder was embedded in parts and components that China had imported and assembled. That hole has since diminished. The percentage of value added in China is now 67% or so.

This evolution is visible even in socks. In Datang, or "Sock City", in Zhejiang province, where 70% of China's socks are made, firms increasingly offer their own branded varieties, rather than making pairs that will be sold under a foreign company's label. China may be producing a declining share of the world's exports. But it now claims a higher share of their value. ■