China's "Common Prosperity" Era: the Spiral of Economic Slowdown & Statist Control

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Since early 2021, President Xi Jinping and China's state media have been promoting "common prosperity" as a new direction of China's economic policy.[1] In Xi's own words, "Capital is an important force to promote social productive forces… Capital is by nature profit-seeking… [but] if not regulated and restrained, it will bring immeasurable harm to economic and social development." The "common prosperity" program is to strengthen guidance and regulatory measures against "disorderly expansion of capital".[2]

Commentators from different political and ideological backgrounds see the "common prosperity" program as an indication that Xi's China is moving away from market reform and sliding back to socialism in the years to come. Scholars on the left celebrate it as a revival of egalitarianism and genuine socialism.[3] Liberal Western politicians lament it as an alarming regression to orthodox Marxism-Leninism and the Mao times.[4]

The term "common prosperity" was not exactly invented by Xi. It first appeared in Chinese Communist Party (CCP) lexicology in the mid-1950s to describe the economy's direction back then, when nationalization of urban enterprises and collectivization of agriculture were in full swing.[5] After the 20th party congress, in which Xi was guaranteed another five years of supreme power and further consolidated his control of the CCP, the draft amendment to the legislative law ditched the mentioning of market opening and development in the guiding principle section altogether. It added in "Xi Jinping Thought".[6] Though the zero-Covid policy has been abolished in the aftermath of a widespread protest against it, Beijing's insistence on such a policy disregarding its economic damage for such a long time shows the CCP's priority of state control and ideological correctness over economic growth. The anxiety (or celebration) that the common prosperity program is an indication of China's departure from free-market capitalism is not far-fetched.

On the other hand, Xi seems to be anxious to dispel any speculation that his common prosperity program is to restore the kind of egalitarianism prevalent in the Mao period. In December 2021, Xi made a speech in the Central Economic Work Conference, attacking welfarism and pledging China would not opt for a high welfare model that encourages "idleness":

> To correctly understand and grasp the strategic goal and implementation path of common prosperity….[we] cannot implement the kind of "welfarism" policy. Some Latin American countries resorted to populism in the past, let high welfare raise a group of lazy people who gain without working. It results in a heavy burden on state finance, making these countries fall into the "middle income trap" and unable to get themselves out for a long time. After welfare goes up, it cannot come down. "Welfarism" beyond one's means is unsustainable. It will inevitably bring serious economic and political problems! We should insist on doing within our means. …We should secure the minimal survival of the masses with difficulties. We should not increase their appetite [for welfare] and make promises that we cannot afford.[7]

This hostility against welfare resembles any speech from any free-market fundamentalist in any capitalist country. It certainly does not look like Marxism or Maoism. So what exactly is the common prosperity program? To see through the smokescreen of official terminology and fully grasp the direction of China's economy in the years to come, we have to first understand that the CCP never recognizes the Chinese economic system as capitalist, but defines it as "market socialism with Chinese characteristics".[8] While many assume such designation is just lip service, Xi's call for "common prosperity" manifests the urge to reinstate the substantive meaning

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1 See Wu Guoguang 2022. "China's Common Prosperity Program: Causes, Challenges, and Implications", Asia Society Policy Institute Report.
2 See CGTN 2022. "Xi stresses further regulations on capital expansions, calls for 'fair competition' for all", CGTN April 30, 2022.
3 David Harvey, 2021. "Whither China?" Anti-Capitalist Chronicles. https://www.youtube.com/watch?v=DZIfYdZqunM
4 Kevin Rudd, 2022. "The Return of Red China: Xi Jinping Brings Back Marxism", *Foreign Affairs*, Nov. 9, 2022.
5 Mao Zedong, 1955. "On the Question of Agircultural Cooperativization", July 31, 1955. http://www.gov.cn/gongbao/shuju/1955/gwyb195518.pdf
6 Bloomberg, 2022. "China Downgrades Priority of Economy for Future Legislation", Bloomberg, Nov. 7, 2022.
7 Xi Jinping, 2022 [2021]. "Correctly understand and grasp the important questions in the theory and praxis of development in our nation" *Qiushi*, 2022, No. 5. http://www.qstheory.cn/dukan/qs/2022-05/15/c_1128649331.htm (My translation).
8 A personal anecdote attesting to this strict official characterization is that when my *China Boom* was translated into a simplified Chinese version by a state-owned publishing house in Beijing, any reference to "capitalism in China" was consistently altered to "market socialism with Chinese characteristics" in the translation. For more discussion, see Ho-fung Hung, 2020. "How Capitalist Is China?" *Socio-Economic Review*, Vol. 18, No. 3, 888–92.

of such designation.

"Market Socialism with Chinese Characteristics": What's in a Name?

Undoubtedly, after more than four decades of market reform, China's economic life has been as capitalist as in many other capitalist countries like the United States and Japan – in the sense that the profit motivation has been the driving force of most economic activities and most means of livelihoods are bought and sold in the market. But despite these commonalities with most capitalist economies in the world, the continuous domination of state ownership, particularly state ownership of land, and the underdevelopment of institutions protecting private property sets China apart. It is exactly the premise of the CCP's insistence that the Chinese economic system is still socialist.

The CCP came to power and transformed the Chinese economy into a socialist one by abolishing private property and establishing the party-state as the single owner of all property after the "socialist transformation" program in the 1950s. Despite the sweeping economic changes that the reform after 1978 has brought, one thing that the party-state has never changed is the state ownership of land as the most significant form of property. The state facilitated the rise of market relations and profit-driven economic activities by granting time-limited use rights of property and means of production to entrepreneurial individuals. This use right comes with an expiration date and is subject to the state for the terms of renewal. The state retains the right to cancel the user right at any time. It is how the rural market reform took off in the late 1970s, when the state instituted the user-responsibility system to lease the use right of land to peasant households while the government continued to hold on to land ownership. In the 1980s, this land system extended to the urban real estate market, in which investors pay for a limited-time use right of the land, usually expiring in four or seven decades, and is renewable, while the state still owns the land on which the property is built.

This continuous state ownership of land property and the denial of absolute private ownership of land, together with the continuous domination of state-owned enterprises, is the foundation of the official designation of the Chinese system as socialist. As the Chinese Constitution states explicitly, the "State upholds the basic economic system in which the public ownership is dominant" (Article 6) and that "The State-owned economy… is the leading force in the national economy. The State ensures the consolidation and growth of the State-owned economy." (Article 7). Also, "[I]and in the cities is owned by the State. Land in the rural and suburban areas is owned by collectives [local governments] … house sites and privately farmed plots of cropland and hilly land are also owned by collectives." (Article 10).

As such, China's political economy over the last few decades has been driven by profiteering activities in a market system grounded in temporary ownership of property by entrepreneurs and individuals. For a long time, the common assumption is that China has been on a long march to become fully capitalist, with the eventual establishment of private property rights just a matter of time. Many would see the state ownership of property as nominal, and the renewal of the use right of land would be routine and ritualistic. More importantly, the booming Chinese economy has been offering a high return on investment. Motivated, enterprising individuals are attracted to keep their wealth and property in China so far as the benefits of profitability and appreciation outweigh the anxiety about the long-term uncertainty of property rights.

However, the situation changed after about 2012, when the China boom ended (we will discuss it in greater detail in a moment). Concomitantly, the confiscation of individual wealth in the name of the anti-corruption campaign became part of normality.[9] The presence and influence of party organizations in private and foreign enterprises expanded.[10] The increasing insecurity of the wealthy and entrepreneurial and the falling profitability in a slowing economy triggered a wave of capital flight. The flight accelerated after the drastic stock market rout and currency depreciation in the summer of 2015. Amidst the economic slowdown, many enterprises and wealthy individuals shifted their priority from taking advantage of the economic boom to moving their wealth out of China into countries with better legal protection of private property. In response, the party-state installed increasingly draconian measures to stem capital outflow.

With the state ownership of all land property and the weak protection of all other forms of property, capitalism in China diverges from most other capitalist economies, including the ones under developmental states, which do guarantee the protection of private property. Under China's market socialism, capital is subordinate to the state. Xi's "common prosperity" program that claims to end the "disorderly expansion of capital" allegedly threatening social stability and national security is a manifestation of such subordination. Concrete measures under the program include cracking down, fining, and even partially taking control of the most successful tech firms and their subsidiaries. It also includes starving some of the biggest real estate developers of financing. The "socialist" principle behind this state's discipling of capital was well articulated in a series

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9 Evan Osnos, 2014. *Age of Ambition: Chasing Fortune, Truth, and Faith in the New China*, Farrar, Straus and Giroux; James Palmer, 2020. "Xi's Latest Purge Reflects Climate of Fear", *Foreign Policy*. https://foreignpolicy.com/2020/08/19/xi-jinping-latest-purge-climate-fear-china-ccp/

10 Scott Livingston, 2020. "The Chinese Communist Party Targets the Private Sector", CSIS. https://www.csis.org/analysis/chinese-communist-party-targets-private-sector

of speeches by Xi on the proper place of entrepreneurship on the eve of the campaign. In those speeches, he reiterated that the party-state should maintain a tutelage role over capital to make sure capital was to serve the larger purpose of the nation and the state:

> Enterprise marketing knows no borders, and entrepreneurs have their motherland. Excellent entrepreneurs must have a high sense of mission and a strong sense of responsibility for the country and the nation, and closely combine the development of their enterprises with the prosperity of the country, the prosperity of the nation and the happiness of the people, and take the initiative to bear the responsibility and share the worries for the country. Patriotism is the glorious tradition of excellent entrepreneurs in China in recent times. From Zhang Jian in the late Qing Dynasty to Lu Zuofu and Chen Jiageng during the war, and then to Rong Yiren and Wang Guangying after the founding of the new China, and so on, are all examples of patriotic entrepreneurs.[11]

Xi's highlighting of the few examples of Qing-era and early 20th-century entrepreneurs, Zhang Jian in particular, is noteworthy. The CCP launched a campaign to promote Zhang as a model entrepreneur in recent years. Xi made a high-profile visit to Zhang's hometown of Nantong in late 2020 in the midst of Beijing's crackdown on big tech. State media and periodicals followed Xi's visit with a barrage of commentaries and articles praising Zhang's achievements and contributions to the "motherland". Zhang, together with other entrepreneurs praised as models, all succeeded as private entrepreneurs early on, then employed their private wealth to start local schools and welfare programs in the place of governments, which were incapable of providing such public goods at the time. They contributed their wealth to support the political and military causes of state-builders. Many of them later "voluntarily" surrendered their businesses and fortunes to the state. This subsidiary role of capital to the state was unseen in other contemporary capitalist economies, though it manifested a certain resemblance to the fascist economic systems in the interwar period.

For a long time, the "market socialist" versus "state capitalist" labels of the Chinese economic system has been like the half empty versus half full label of a glass of water. They are both right and emphasize different aspects of the same hybrid system. While many analysts characterizing the Chinese economy as state capitalist predict or advocate a transition to full market capitalism, Xi's common prosperity program is to assure that the dominance of the state sector and state ownership is not a transitory phase of Chinese development, but is going to stay in the years to come. As such, uncertainty about whether China will continue to converge with free-market capitalism in the West has ended. Xi has firmly set China on the course of entrenched state ownership and state dominance of the economy in the long run. This choice by Xi, or the party-state elite in general, stems from the long slowdown of the Chinese economy since the early 2010s.

The End of the China Boom

China's export sector, dominated by private and foreign enterprises, has been the source of its economic dynamism and profitability since it moved toward export-oriented growth in the mid-1990s.[12] The export sector absorbed mammoth foreign exchange reserves. The reserves have been the foundation of the expansion of state bank credit, which mostly flowed to well-connected enterprises to support many of their fixed-asset investments, such as infrastructure construction, real estate projects, the building of new steel mills and coal plants, etc. So far as the foreign exchange reserves are growing, the CCP-controlled financial system could increase local currency liquidity in the form of generous bank loans without increasing the risk of devaluation and capital flight. Devaluation and capital flight are typical to many developing countries that pursue credit expansion without commensurate forex reserves expansion.

Many of the debt-driven fixed-asset investments are redundant and profitless. Chinese leaders have warned about the indebtedness and overcapacity of the economy since the late 1990s. They proposed reforms such as depriving inefficient enterprises of state banks' cheap loans through financial liberalization. As the profitless and recklessly expanding economic sectors became cash cows and quasi-fiefdoms of different factions of the party-state elite, any such reform never gained any traction.[13]

When the long boom of China's export-led growth faltered in the global financial crisis in 2008-2009, the Chinese government unleashed an aggressive monetary stimulus program that successfully fostered a strong economic rebound driven by debt-financed fixed asset investment. The weakening of the export engine and the redoubled investment expansion financed by state banks during the 2009-2010 rebound created a debt bubble no longer matched by the expansion of the foreign exchange reserves. Between

11 Xi's Speech at Private Entrepreneurs Symposium, Beijing, July 21, 2020. http://www.xinhuanet.com/politics/2020-07/21/c_1126267575.htm (My translation).

12 Ho-fung Hung, 2021. "The periphery in the making of globalization: the China Lobby and the Reversal of Clinton's China Trade Policy, 1993–1994", *Review of International Political Economy*, 28:4, 1004-1027.

13 Peter Foster, 2010. "WikiLeaks: China's Politburo a cabal of business empires", *The Telegraph*, Dec. 6, 2010. https://www.telegraph.co.uk/news/worldnews/wikileaks/8184216/WikiLeaks-Chinas-Politburo-a-cabal-of-business-empires.html

2008 and late 2017, outstanding debt in China soared from 148% of GDP to over 250%. The surge of loans amidst the 2020 pandemic further pushed the share to more than 330%, according to one estimation.[14]

The many apartments, coal plants, steel mills, and infrastructure financed by debt became excess capacity and would not be profitable. After the 2009-2010 rebound, the profitability of enterprises kept falling across the board in both private and state sectors, as shown in *Chart 1*. Falling profits of enterprises makes debt servicing and loan repayment challenging, creating a debt time-bomb. As such, China ran out of room for growth through debt-financed fixed-asset investment while export sector growth had not rebounded to the pre-2008 level.

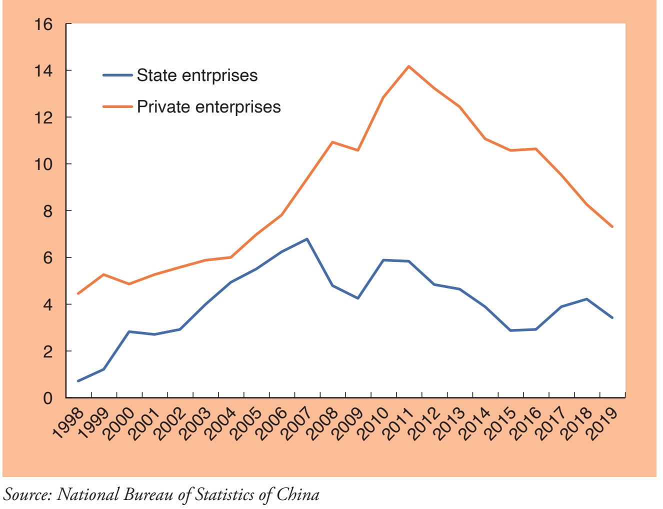
Beijing has long called for a rebalancing of the Chinese economy by boosting domestic private consumption to digest excess capacity even before the global financial crisis of 2008. Though private consumption did climb rapidly since China's accession to the WTO, its share of GDP remained low as it never grew fast enough to catch up with the expansion in investment. The disappointing growth of the private consumption share in the economy resulted from aggravating inequality. Through the China boom, average household income grew much slower than the economy at large, meaning most of the economy's newly generated income went to the government and enterprises, turning into more investment and excess capacity instead of consumption *(Chart 2)*.

Excess capacity, falling profits, and increasing indebtedness across the economy underlined the stock market meltdown and capital flight that drove the Chinese currency's sharp devaluation in 2015-2016. The economy stabilized in 2016 only with the renewed tightening of capital control. The banking system also injected rounds of new loans into the economy to prevent it from slowing too much. Much of the loans are used for the rollover of existing loans. These recurrent and ever-larger loan surges brought a further buildup of indebtedness in the economy without adding new dynamism. Many enterprises became loan-addicted zombies. This impasse in the Chinese economy is illustrated by the stagnation of its manufacturing expansion, as shown in the manufacturing Purchasing Manager Index (PMI), a lead indicator of manufacturing activities that hovered around the stagnation line of 50. Comparing the new loan data with the PMI, we can see the diminishing effectiveness of loan stimulus. It took ever-larger loans to bring the economy's ever-smaller rebound after the 2009-2010 rebound *(Chart 3)*.

With cessation of the robust growth of the economic pie, the state sector, with the assistance of the party-state, increases its squeeze of the private sector and foreign companies. The "advance of the state sector and retreat of the private sector" *(guojin mintui)* became obvious when the anti-monopoly law, implemented in 2008, was

CHART 1

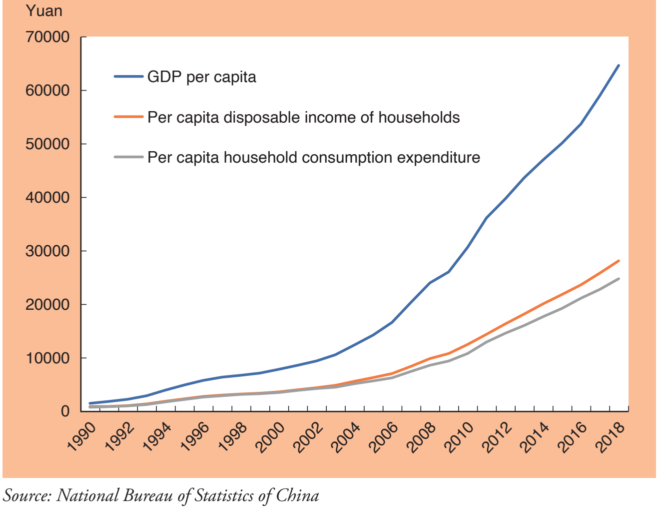
Profit-to-asset ratio in state & private enterprises (%)



Source: National Bureau of Statistics of China

CHART 2

GDP per capita, per capita disposable household income, & per capita household consumption expenditure in China, 1990-2018



Source: National Bureau of Statistics of China

14 Institute of International Finance, 2020. "Global Debt Monitor: Sharp spike in debt ratios", Institute of International Finance. https://www.iif.com/Portals/0/Files/content/Research/Global Debt Monitor_July2020.pdf

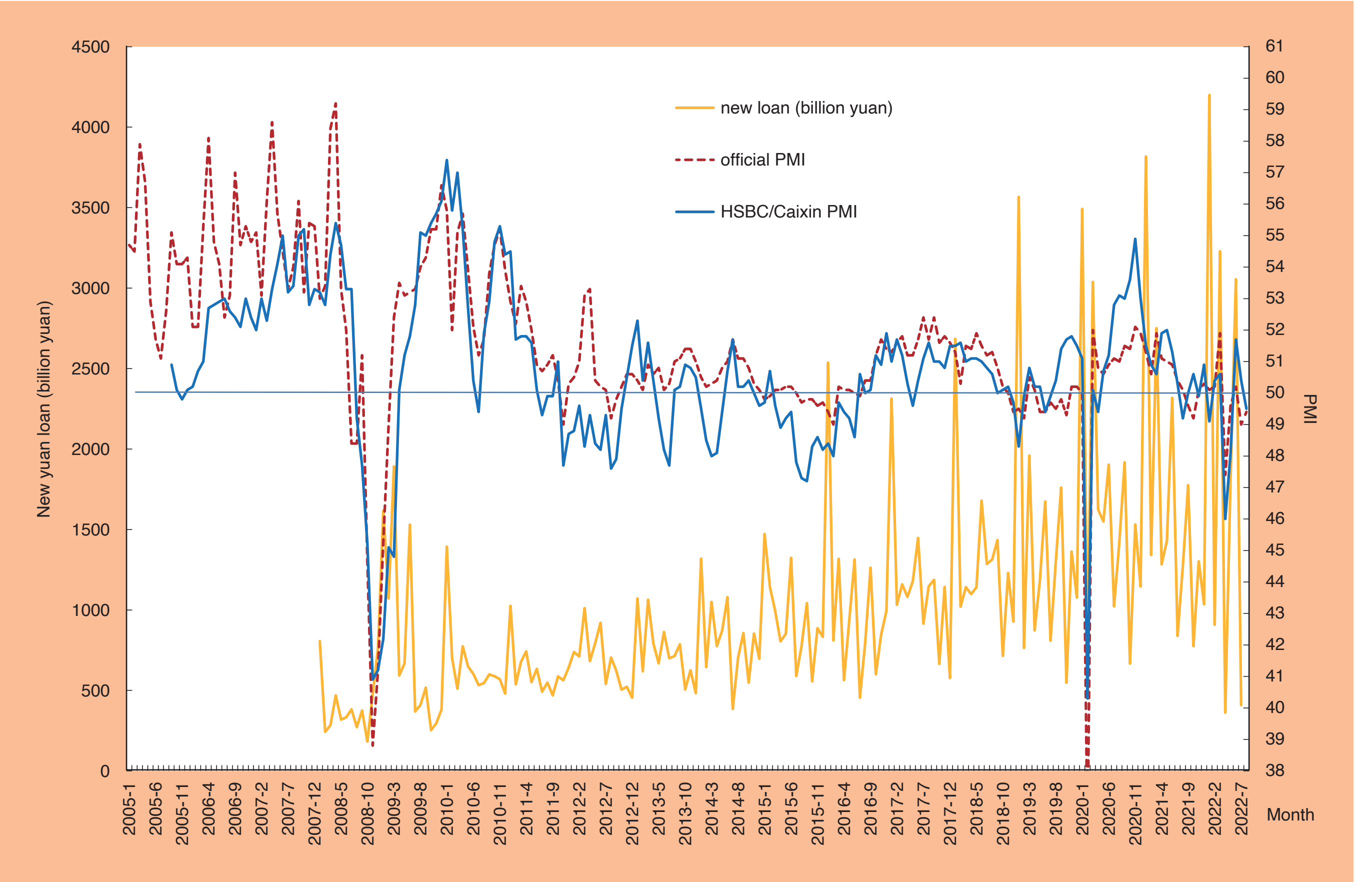
used much more against private and foreign enterprises than state-owned ones.[15] To be sure, many individual party bosses of state enterprises have been purged in intra-elite conflict in the name of anti-corruption. Still, the anti-monopoly law rarely touched the privileges of state enterprises, even though many enjoyed a monopoly in key sectors like telecommunications and energy. This squeeze of the private sector and foreign enterprises by the state sector amidst a general economic slowdown is partly an effort to aid the growth of state firms at the expense of private firms in a shrinking pie.

Advance of the State *vis-à-vis* Private Enterprises

When China opened up to the global economy, Beijing never let go of state-owned companies' domination in key sectors. The state-owned enterprises' reform over the 1990s was not exactly a privatization reform. While many state-owned giants were restructured after the model of profit-oriented Western transnational corporations, shedding nearly all of their social functions such as providing housing and healthcare to their employees, many of the largest ones were still controlled by the local or central governments through direct state ownership or state shareholding of public companies. Chinese companies in the Global Fortune 500 list grew from 10 in 2000 to 124 in 2020. Of the 124, 91 are state-owned enterprises.[16] State-owned industrial assets nearly double the size of private industrial assets in the whole economy, with state-owned assets occupying a predominant role in finance, energy, automobile, telecommunication, mining, etc. Real estate development, online

CHART 3

Manufacturing PMI & monthly new loans, 2005-2022



Source: Bureau of National Statistics of China; HSBC/Caixin

15 US-China Business Council, 2014. "Competition Policy and Enforcement in China" https://www.uschina.org/reports/competition-policy-and-enforcement-china
16 Kennedy, Scott. 2020. "The Biggest But Not the Strongest: China's Place in the Fortune Global 500". CSIS Report, Aug. 18. https://bit.ly/3cBdVZg.

retailing, social media, etc., are the sectors where private capital still dominates.

When Xi first came to power, he was expected to pursue an economic liberalization agenda. Official media in the early days of his rule discussed financial liberalization reform to starve unprofitable but privileged enterprises of credit.[17] State newspapers published articles believed to be endorsed by Xi to call for a “supply-side structural reform”, which “sounds less like Marx and Mao than Reagan and Thatcher”. Very soon, this expectation about a strong man pushing for further market reform, Deng Xiaoping style, fell flat. The vested interests in the state are so strong that Xi has little choice but to double down on the policy of supporting the continuous expansion of state-owned or state-connected companies at the expense of private and foreign ones. It is a consensus now that the statist turn of the Chinese economy, though predating Xi, accelerated significantly under him.[18]

Such re-insertion of the state in the economy accelerated with Xi’s common prosperity program. In the name of the program, Beijing cracked down hard on giant private enterprises like Alibaba and Tencent, both founded by private entrepreneurs and incorporated in the Cayman Islands. Such measures include barring Ant Group, Alibaba's fintech arm, from overseas IPO at the last minute, imposing a hefty anti-monopoly fine on Alibaba, adding heavy restrictions on technology firms in collecting data and providing services, banning for-profit school tutoring firms, and letting state firms take over key assets of private tech firms, to name a few.

Under this initiative to restrain the growth of private capital, Beijing reined in on the easy financing to privately owned property developers in 2020. Cut off from new financing sources to roll over their preexisting and snowballing debts, many real estate developers suddenly fell into a solvency crisis, with the crisis of Evergrande, the leading company in the sector, as the most widely watched one. The plausible default and implosion of Evergrande has caught the world in cross-hairs. Creditors, investors, contractors, customers, and employees of Evergrande within and outside China were anxious to see whether the Chinese government would decide that Evergrande was too big to fail and eventually rescue it with some form of a bailout. Beijing was in a dilemma. If it did not bail out Evergrande and it collapsed, the repercussions throughout the financial system and construction supply chains would be unpredictable. Reportedly, Beijing has issued a warning to local governments to brace for the possible social and political fallout if Evergrande eventually collapsed. If Beijing did bail out Evergrande in one form or other, it would not be the last troubled property developer in need of a government bailout. Myriad other developers are in a similarly dire situation and could default in the months to come.

It is also reported that one solution to the Evergrande crisis that the Chinese government was pondering was to break down and restructure the company into state-owned enterprises.[19] The Evergrande crisis could be an opportunity for the party-state to nationalize the largest property developer in the economy, reasserting the state’s substantive ownership of land property. This development is consistent with the state’s recent attack on other giant private enterprises, with the possible development of turning these companies or parts of these companies into state-owned or state-controlled ones.

Some argue that such a crackdown on private enterprises would deprive the Chinese economy of the dynamism that has been the source of China’s rapid growth in the last few decades. With the profound structural imbalance of the Chinese economy, it is not likely China could overcome the long slowdown in the coming decade. Robust economic performance, expanding employment, and rising income have been the linchpin of the claim to legitimacy of the CCP authoritarian state since the 1990s. With this source of legitimacy gone under a structural crisis of the economy, the CCP certainly has to find an alternative pathway to secure its regime survival. In this context, redoubling the party-state’s direct control of society and the economy, even at the cost of aggravating the economic crisis, which is inevitable anyway, becomes a rational approach from the standpoint of the party-state elite. As such, China has entered a long downward spiral of deepening slowdown and tightening statist control of the economy. JS

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17 Isaac Stone Fish, 2018. “The Myth of a Kinder, Gentler Xi Jinping”, *The Atlantic* https://www.theatlantic.com/international/archive/2018/02/xi-jinping-authoritarianism-china/554375/
18 Nicholas Lardy, 2019. *The State Strikes Back: The End of Economic Reform in China?* Washington, DC: Peterson Institute for International Economics.
19 Henry Chia, 2021. “Imminent China Evergrande deal will see CCP take control”, *Asia Markets*, Sept. 21, 2022. https://asiamarkets.com/imminent-china-evergrande-deal-will-see-ccp-take-control/