Section 4
The Rapidly Recovering Chinese Economy and Its Presence in the World

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1. The Chinese Economy and Its Recovery from the COVID-19 Pandemic

(1) COVID-19 Measures Supported by Utilitarianism

In *China: A Happy Surveillance Nation* co-authored with Mr. Kota Takaguchi, I evaluated China's governance system as a "happy surveillance nation" based on the combined philosophies of paternalism and utilitarianism. The nation provides its citizens with convenience and economic benefits using big data, and at the same time, it aims to stabilize society and to improve public safety using this data (Kajitani and Takaguchi, 2019). Such a governance system appeared even more clearly in 2020 from the COVID-19 measures taken by the Chinese government and society during the COVID-19 pandemic.

The Chinese government thoroughly deployed paternalistic intervention in people's lives when taking counter-measures against the novel coronavirus. Specifically, the government blockaded Wuhan City, rapidly constructed isolation hospitals, mobilized medical staff from all over the country, and enforced facial mask production. It also implemented thorough quarantine and isolation measures using personal data collected through smartphones, including contact information with others (Uragami, 2020).

The decisions made in accordance with utilitarianism are also effective in specifying and isolating infected persons with the full use of the surveillance technology. In the COVID-19 pandemic, China used the Health Code, which was developed through the extension of the previous technologies. The Health Code uses colors to indicate the infection risk of each person by using a combination of information, such as smartphone location information data collected through the applications of major IT companies like Alipay and WeChat Pay, movement records by public transportation providers, and people's health information. When the possibility of being infected is identified, the Health Code turns yellow or red depending on the degree of possibility of infection, and in such a case, the use of many facilities including restaurants becomes prohibited. It is already well-known in Japan that the Chinese government has been advancing such a quarantine system by thoroughly controlling personal information.

(2) Suppressed Direct Benefits

China ensured surveillance and isolation with the skillful use of IT technology, as well as through physical and human mobilization, and controlled the infection. But what economic measures did China take to support an economic recovery? We will explain them below, focusing particularly on fiscal policies.

In November of last year, the IMF published data on how much each country has increased expenditure on COVID-19-related financial affairs and measures. Based on this data, Figure 1-4-1 compiles each country's financial support and additional fiscal support.

The Figure indicates that as of September of last year, European nations were prominent particularly in terms of financial support. For additional fiscal support, Japan recorded around 10% of GDP, which is quite high, and the US undoubtedly recorded the highest. The US took fiscal action with spending of about USD 2.2 trillion or about 9.3% of GDP, including cash benefits, by March 2020 during the Trump Administration period. In April, the Congress decided on an additional economic measure of USD 484 billion. Further, it signed-off on a plan for an additional economic measure for USD 1.9 trillion including a cash benefit of a maximum of USD 2,000 per person on March 11, 2021, after the start of the Biden Administration.

Meanwhile, China's additional government spending was about 4.5% of GDP. It consisted of expenditure of CNY 147 billion on the medical area (e.g. preventing and controlling the epidemic, improving the public sanitation emergency management system, etc.) and CNY 3.1 trillion on non-medical areas including providing funds for municipalities' employment initiatives, enlarging the applicable ranges of minimum life security and benefits, and expanding the social support program for poor households. While the amount itself does not look so

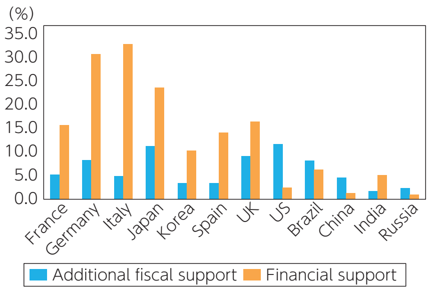

Figure 1-4-1 COVID-19 related fiscal & financial support measures by major governments (GDP ratio)

Source: Database of Country Fiscal Measures in Response to the COVID-19 Pandemic
Note: The values are as of September 11, 2020.

small, this additional government spending includes CNY 1.6 trillion to increase the authorized limit of special municipal bonds issued as financial resources for infrastructure investment. That is to say, more than half of the additional government spending is allocated for the implementation of industrial policies such as subsidies for purchases of new-energy vehicles and capital investment in the construction of new infrastructure such as 5G.

But this does not mean that China allocates no government spending to workers who were made unemployed and to businesses that were forced to close. For example, the additional government spending includes refunds for social insurance premiums paid in 2019 by the companies that did not make employees unemployed or that minimized dismissals. It also includes the payments of unemployment allowance or minimum life security made to migrant workers who returned home. Further, a financial burden of CNY 1.5 trillion was also reduced. This includes the exemption or postponement of social security payments for small and medium-sized companies and the exemption or reduction of value-added tax payments, mainly for companies in Hubei Province. It also includes a corporate income tax reduction by implementing an investment allowance of 100% for companies whose businesses were affected by the COVID-19 pandemic. So it is noteworthy that support was provided in the form of exempting or deferring social insurance premiums and tax burdens in all cases, but hardly at all in the form of directly distributing benefits to individuals and businesses.

That is, direct benefits provided to individuals and businesses seem to have been extremely suppressed compared to in the US and Japan. Instead, low-paid workers who lost their jobs were encouraged to subsist through conducting self-help efforts, of becoming stallholders or performing gig-work. For instance, when Prime Minister Li Keqiang visited Yantai City in Shandong Province in May 2020, he praised the robustness of stallholders, commenting that he expected that "the street stall economy" or the informal sector would provide unemployed persons with temporary employment opportunities.[1)]

Part Ⅰ
Part Ⅱ
Part Ⅲ
Part Ⅳ

1) "100,000 People Found Jobs in One Night! Hot Street Stall Economy! Praised by Prime Minister! Night Market in Hubei Attracting a Large Crowd" dated June 3, 2020, the Chinese Central Government's Official Web Portal (http://gov.cn/xinwen/2020-06/03/content_5516900.htm), accessed on May 31, 2021

2. Issues Faced by the Chinese Economy

(1) A Growth Strategy Emphasizing the Supply-side

As stated in the previous subsection, China promptly resumed economic activities and achieved a V-shaped recovery in the second half of 2020. The nation did so by thoroughly controlling the infection, tracking people's movements with the full use of digital technology such as the Health Code, and conducting careful examinations and isolating those with a high infection risk (Figure 1-4-2).

According to the official statistics, the real GDP growth rate in 2020 was 2.3%. In terms of the growth rate in 2021, the IMF forecasted that the real GDP growth rate would be 7.9%. On the other hand, the targeted real GDP growth, which was shown in the government activity report at the National People's Congress 2021, was at least 6%, which is fairly modest compared to the forecast.

What direction will the Chinese economy aim for? As early as March 2020, the Communist Party of China had released a document entitled Opinions on the More Complete Arrangement System of the Production Factor Market and the Establishment of its Mechanism. This document shows important points when seeing the future trends of economic development announced by the Chinese government (Research Office for China, Research and Advisory Department, 2020).

The document emphasizes the directions of the five main production factors: land, labor, capital, technology and data. That is, the Chinese government will 1) realize a highly-effective arrangement in line with the market mechanism, and 2) eliminate systematic causes that hinder the smooth movements of

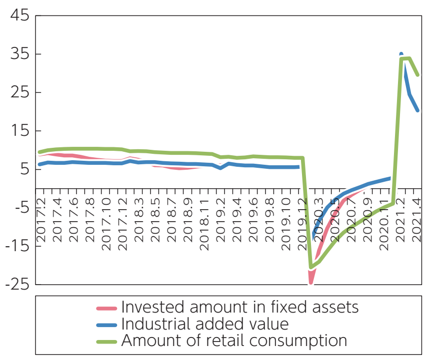

Figure 1-4-2 Changes in various economic indices

Source: Website of the National Bureau of Statistics of China: http://www.stats.gov.cn/
Note: All values are cumulative values from the beginning of the year.

factors and facilitate the establishment and development of the production factor market. In the backdrop to this is the implementation of supply-side reforms that bring about industrial shakeouts that reduce excess production capacity. It seems that the government is attempting to effectively provide jobs to unemployed people, who are overflowing due to the shakeouts, by changing the labor market.

Another significant point when predicting the Chinese economy's trends in the future is the term "domestic general circulation." The government addressed this term as a replacement of overseas capital expenditure typified by the Belt and Road Initiative or international general circulation, which the government had focused on.

The term "domestic general circulation" was used when a policy based on a new growth framework was released in the Political Bureau of the Communist Party of China (CPC) Central Committee Meeting held in July 2020. The policy aims to facilitate domestic and international dual circulation, particularly focusing on domestic general circulation. In addition, domestic general circulation was defined in the proposal of the 14th Five-Year Plan, which was approved in the fifth plenary session of the 19th CPC Central Committee held in October of the same year. It was defined as "to break down industrial monopolization and regional protection in each segment of the domestic market, production line, allocation, distribution and consumption, and to bring about the favorable circulation of the national economy." With this definition, the nature of domestic general circulation became clear; namely, that the government intends to punish regional governments' protectionism and to facilitate supply-side reforms through the marketization of production factors.

In other words, domestic general circulation appears to inherit the trend of aiming for a different growth pattern from rough growth by facilitating supply-side reforms or flowing production factors. The Chinese government had been addressing supply-side reforms as a long-term economic development policy since 2014. At the same time, the government had addressed active overseas investment, as typified by the so-called Belt and Road Initiative, as one of the new economic growth models. It is expected that overseas investment will be toned down, and that economic growth will be driven by the effective rearrangement of production factors such as land, the labor force and capital, as well as by decarbonization businesses like new-energy vehicles.

(2) Future Issues for the Chinese Economy

Next, we will look at some of the issues that the Chinese economy might face.

The first issue is the recurrence of the debt problem. As seen in the BIS statistics showing the debt-to-GDP ratio of each country, the ratio of the corporate sector had been curbed to the level of 149.3% of GDP at the end of 2019 through the so-called deleverage policy. The ratio had increased to 163.1% at the end of September 2020 due to an increase in borrowing by companies whose businesses were directly affected by the COVID-19 pandemic. Under such circumstances, it is actively argued that the corporate sector's excess debt problem may recur.

As if confirming the argument, it was revealed that the Tsinghua Unigroup, a large public semiconductor manufacturer, experienced difficulties in funding in early November 2020. In 2021, it was reported that China Huarong Asset Management, a bad-debt disposal company that is 60% owned by the Ministry of Financing, had fallen into credit uncertainty. As such, it was repeatedly reported that the financial positions of large public companies were deteriorating. According to a news report on May 13 by *The Nikkei*, the amount of corporate bonds maturing in three years up to 2023 will reach a total of USD 2.14 trillion or over JPY 230 trillion, 1.6 times larger than in 2018 through 2020.

When faced with the severe economic turmoil brought about by the COVID-19 pandemic, the US took expansionary economic measures without caring about an increase in sovereign debt. In contrast, the Chinese government took such measures in a suppressive manner, which caused the corporate sector's debt to expand. That is, if the Chinese government considers the expanded corporate sector's debt as a true crisis, it can shoulder the debt by actively issuing treasury bonds, and the nation's finances possess sufficient strength to do so. In this respect, I believe that this issue is not as big of a crisis as is widely argued at the moment.

The second issue for the Chinese economy is the employment situation. China's surveyed unemployment rate peaked at 6.2% in February 2020 and continued to fall thereafter. Meanwhile, it has been pointed out that the value of this rate does not necessarily reflect the reality. An especially important point is that it does not count the number of migrant workers from rural areas. According to an expert's estimate, the number of unemployed people in urban areas was 70 to 80 million people when the employment situation was at its most severe in the fiscal year ended March 2020, which resulted in the unemployment rate reaching about 20% (Zhang, 2020).

The unemployment rate has been declining thereafter. However, it became apparent that small and medium-sized companies, particularly in industries such as the service industry that have experienced a demand shock, survived the crisis by reducing their employment of low-skilled peripheral workers, because these companies receive no support from the government. Even after the unemployment rate declined, issues such as the employment of new college graduates and stagnant wages have been identified, although the employment situation has recovered. Considering that the economic recovery from the COVID-19 crisis was supported by the unstable employment of peripheral workers like migrant workers and gig-workers, there is no doubt that stable employment will be one of the most important points for the Chinese economy going forward.

The third issue is constraints on private-sector platformers, as typified by the Alibaba Group. This issue arose when the IPO of Ant Group, an affiliated financing company in the Alibaba Group, was suddenly suspended in November 2020.

Large platformers like Alibaba have risen to prominence under a protection policy that restricts the activities of the leading US IT companies named GAFA (Google, Apple Facebook, Amazon) and have the characteristic of being the products of industrial policies. Meanwhile, Alibaba's activities are about to be heavily restricted at present, because its presence and influence on society and economy have become too large. It is still fresh in our minds that Alibaba was fined as much as CNY 18.228 billion in April 2021 for the so-called "one out of two" measure, which prohibited competitors from opening e-commerce stores and impeded fair transactions.

The Alibaba Group is not the only target of restrictions. On November 10, 2020, the Chinese government disclosed its draft antimonopoly guidelines for the internet platform economy. In December of the same year, antimonopoly measures and the prevention of unplanned capital expansion were emphasized at the Central Economic Work Conference. With this policy, other major IT companies, including Alibaba's competitors such as Tencent, also become investigation targets based on the application of the Antimonopoly Act.

As the reason that the government strengthened restrictions imposed on Alibaba, it is pointed out that the public banking sector is concerned that the aggressive financial services by Ant Financial, an Alibaba Group company, will put pressure on banking businesses. The opinion of Prof. Fujio Kawashima of Kobe University is that the intimate relationship between the government and the platformers is over. This is evidenced from the fact that the People's Bank of China can collect consumer information through its digital-CNY initiative without depending on the settlement services of platformers such as Alipay, and that the policy possibly reflects the intention of the financial authority to emphasize this regulation (Kawashima, 2021).

These platformers' funding ability has largely supported innovation in China's high-tech area until now. If the enforced regulation hinders this momentum, it will become a major challenge for Chinese companies' continuous innovation going forward.

3. Direction of the US-China Friction and China's Rising Presence

I assume few people object to the idea that the largest issue for the Chinese economy is the friction with the US. There is no doubt that the US-China tariff battle, which occurred in 2018 under the Trump Administration, significantly impacted China's domestic economy.

Figure 1-4-3 indicates the trend of the economic policy uncertainty index, which indexes uncertainty about economic policies and rising anxiety about the economic outlook in the future due to the involvement of these policies, based on the frequency of economic terms being used in each country's newspaper reports.

As is clear from the trend of the index, amid concerns that the intensifying conflict between the US and China will increase uncertainty in the global economy, in the trade talks on January 15, 2020, the US and Chinese governments reached a partial agreement called the Phase One agreement.

The Phase One agreement is limited to areas such as import tariff reductions and the enforced protection of intellectual property. Areas like industrial subsidies, which are hard for China to compromise on, have been postponed to the Phase Two agreement.

The hurdle for future trade negotiations between the two nations is the abolition of industrial policies by the Chinese government, particularly in the high-tech area, which was shelved in the Phase One agreement. The US has asked China to abolish industrial subsidies, particularly those provided by the

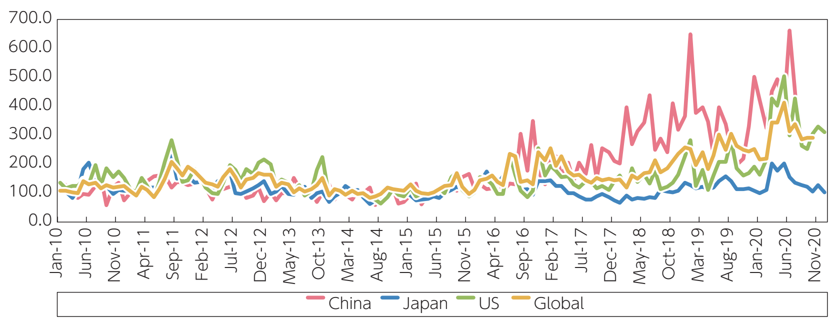

Figure 1-4-3 Changes in economic policy uncertainty

Source: Economic Policy Uncertainty (http://www.policyuncertainty.com/index.html) central and regional governments, because the subsidies provide an advantage for Chinese high-tech companies. But China would not agree to the condition of abolishing subsidies provided by regional governments, and this makes an agreement between the two nations difficult.

A large hurdle for the trade negotiations between the US and China is the Chinese government's direct support for Chinese companies through industrial policies, particularly its so-called industrial subsidies. However, not many industrial subsidies are directly paid from government spending. Instead, what has had an increased presence in the support for the "new industries" in recent years in China are the investment funds in which the government is involved in some way.

In parallel with the rapid expansion of venture capital, various sovereign investment funds have also been established. From the perspective of facilitating innovation, "industrial investment funds (government guidance funds)" have increased their presence. These funds invest in government projects and support the optimization of industrial structures, such as through corporate fundraising and mergers with funds collected from lenders like government agencies, financial institutions, corporations, PE funds and public pensions. For instance, an industrial investment fund, which was established to support the integrated-circuit (IC) industry in September 2014, was larger in scale than the government subsidies. It has been noted that the government reinforced its influence on the advanced IC industry through this fund.

Nevertheless, it is difficult to judge whether these investment funds, particularly those established by regional governments, are "bad industrial policies" that distort markets and damage fair competition due to government intervention, as the US claims.

For instance, not all China's government guidance funds are so-called national policy funds like the National Integrated Circuit Industry Investment Fund and the Advanced Manufacturing Industry Investment Fund that targets an asset size of CNY 50 billion or over, which the US considers to be a problem. According to the Research Report on the Development of China Government Guidance Funds 2019 issued by pedata.cn, government guidance funds are roughly classified into three groups. The largest group is mother funds; that is, mother funds themselves that do not directly invest in companies, and funds under the umbrellas of mother funds that invest in companies. The next largest group is funds established by regional governments that directly invest in specific companies. The last group is funds in a PPP fund format that collect money from the private sector and invest it in infrastructure projects led by the regional government. Among the government guidance funds, the overwhelming majority are small and medium-sized funds targeting an asset size of CNY 10 billion or less. Funds targeting asset sizes of CNY 1 billion or less and between CNY 1 and 10 billion comprise 43.2% and 36.8% of all funds, respectively.

The regional governments established many of these small-sized funds to support local companies, to secure employment, and to promote the regions. This is the way that the Chinese government has continued to provide backing with policies since the 1980s, so that the regional governments support local companies. It seems difficult for the government to accept the complete termination of such a traditional method.

Conclusion

In recent years, industrial policies have attracted economists' attention more and more. Aiginger and Rodrik point out that the reasons behind this are the requests for changes to the industrial structures in developing nations, the prolonged deterioration of the labor markets and the financial crises in advanced nations, and the significant changes in technologies (Aiginger and Rodrik, 2020). A notable point is that they mentioned China's presence as a factor involved in all of the above reasons.

In the first place, standard economic theory suggests that investment decisions should be left to the private sector as long as market failure does not occur. Since the beginning of the 21st century, however, various industrial policies have been implemented and the effects have been evaluated on the grounds of "knowledge spillovers" due to stagnant technological progress and sluggish research and development costs.

It cannot be said that the industrial policies that the Chinese government is advancing are totally based on the philosophy of state capitalism and distorting markets, as some argue. In fact, considering the current trend in economics, many of those policies can withstand a full evaluation.

So far, China's industrial policies have fully pursued economic efficiencies and the implementation methods have also been sophisticated, ascertaining global trends including in Western nations. Keeping these facts in mind, we should pay close attention to developments in China in the future.

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