

## China's Third Plenum Endorses the "Decisive" Role of the Market — Unfortunately for China

The Third Plenary Meeting of the 18th Central Committee of the Communist Party of China (the 'Third Plenum') took place November 9-13 in the Great Hall of the People in Beijing. The Central Committee of the CPC holds plenary meetings once every year or so to debate and announce new policies. China is currently ruled by the 18th incarnation of the CPC Central Committee (each incarnation lasts about five years). The third plenary meeting of each Central Committee is traditionally the venue for announcing major policy changes. The just-passed Third Plenum did not disappoint.

The sweeping reform announced at the conclusion of the Third Plenum consisted of changing one word in all the hot air of CPC so-called socialist rhetoric: henceforth the role of the market in economic decision-making will be 'decisive'. As recently as October 7 of this year the role of the market was officially 'basic', as noted by Bloomberg. What is the difference between 'basic' and 'decisive'? At a minimum it means further currency market liberalization and allowing the creation of privately owned banks. At a maximum it means much, much more.

The central government in Beijing has signaled that it wants to rein in profligate spending by local governments across the country. It has directed state-owned banks to reduce lending for new construction projects and has shelved plans for subway construction in many major cities. The new watchword is profitability. If a major infrastructure project can't prove that it will turn a profit, the central government wants to see it closed down. All of this has been done under the banner of working toward maintaining 'sustainable' growth.

Of course, in China 'sustainable' is taken to mean 7.5% annual growth instead of the double-digit growth of the last twenty years. I predicted this slowdown in a September 2011 article in *Foreign Affairs* magazine and reiterated it in a 2012 follow-up article. Back in 2011 — just two years ago — the official IMF long-term growth forecast for China was 10.5%. Now it's 7%. My own prediction from 2011 was that China's growth would slow to normal middle-income country levels of 3% or 4% by 2020. Now the even the economic pundits seem to agree that the Chinese economy may not grow forever.

Making the market 'decisive' means that the Chinese government has decided to place profits before people — and even before that previously invincible talisman, economic growth. Faced with its first slowdown in twenty years, it has decided to maintain profits growth even if that means accepting a slower growth rate for the economy as a whole and job losses for ordinary people. No more extraordinary over-investment in infrastructure and housing, no more low-ball pricing of public goods to keep the pressure on private companies. The CPC has decided to let the market decide.

The smart money in China is increasingly investing abroad, even in recession-plagued California housing market, rather than in China. Foreign exchange liberalization will only accelerate this trend toward capital flight. Meanwhile China itself has become the main engine of profits growth

for many western companies. All this is in line with government plans to transform China into a normal economy. Normal middle-income countries like Brazil, Mexico, and Russia are characterized by low government investment, high capital flight, and uneven economic growth. As China turns its economic decision-making over to the market, it is set to join this undistinguished club.