Xi Jinping's Pivot to the State

The impact of ideology, demography, and decoupling on China's new economic policy framework

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People have been trying to make analytical sense of the rapid series of economic policy decisions by Xi Jinping's administration over the course of the last year.

There have been, at times, a bewildering array of them:

- The decision to suspend Alibaba's financial affiliate, Ant Group's, planned IPO in Hong Kong and Shanghai last October;
- The announcement in April this year by China's market regulator, the State Administration for Market Regulation (SAMR), to impose a USD $3 billion fine on Alibaba itself for "monopolistic behavior";
- That same month, another SAMR inquiry into suspected monopoly practices by food delivery giant Meituan;
- The decision in July this year by the Chinese cyber-regulator (the Cyberspace Administration of China, or CAC) to remove China's ride-hailing giant, Didi's, app from stores while a joint investigative unit was established to examine Didi's compliance with China's data security laws (followed in August by summons by China's Transport Ministry regulators to haul in senior executives from Didi, Meituan, and another nine companies, directing them to "self-rectify their misconduct by December");
- The decision also by the Chinese Government to take a one percent equity stake in ByteDance's Beijing subsidiary, the owners of TikTok;
- A similar decision to secure equity in China's micro-blogging platform, Weibo; and
- The decision also in July by the education regulators to issue new regulations effectively killing China's private tutorial sector by forcing firms to become non-profits.

It is not, however, just this impressive list of administrative actions against individual firms that has caught the domestic and international investment community by surprise. The Chinese Government has also been busy promulgating a series of new regulations across the private sector, including:

- New rules released by the State Council in August putting all Chinese firms in the telecoms, energy, transport, finance, and defense sectors under close cybersecurity scrutiny to protect what is described as "critical information infrastructure";
- Also in August, new draft rules by SAMR to tackle market competition in the internet sector and to rein in the handling of critical data by corporations (following the Ministry of Information and Technology publicly attacking 43 different apps, including those of WeChat and Tencent, for illegally sharing data); and
- This was followed in August by the National People's Congress Standing Committee passing China's first national data privacy law, the so-called Personal Information Protection Law, requiring any corporation or individual handling Chinese citizens' personal data to obtain prior consent from consumers first; and preventing data from being passed to other corporations in "unsecure" countries.

And beyond these individual actions against companies, and the frenetic pace of regulatory activity by the NPC, the State Council, and individual government agencies, Xi Jinping has been advancing a new overarching economic policy framework over the course of this year entitled the "New Development Concept" — a concept which incorporates within it a range of different elements, including:

- Xi's 2020 idea of a "dual circulation economy," which seeks to reduce China's future dependency on export-driven growth, and instead have Chinese domestic consumer demand become the principal growth driver; thereby leveraging the enormous "gravitational pull" of the Chinese domestic economy on the rest of the global economy;
- Second, his 2021 prioritization of the idea of "Common Prosperity," which emphasizes income redistribution away from China's billionaire class to low- and middle-income earners; and
- Third, the continued expansion of China's "industrial policy," led by a revamped state-owned sector, as China seeks to take the commanding heights of new technology platforms as the drivers of the 21st century global economy, including semi-conductors, artificial intelligence, quantum computing, and new forms of advanced manufacturing.

For many in the international community, as well as China's own entrepreneurial class, this has been received as a surprising, bewildering, almost scattergun series of announcements — from the micro to the macro.

I would argue, however, that there is a common "red thread" to all of the above — particularly when seen through the political lens of Xi Jinping's office in *Zhongnanhai*, rather than through the financial analyst lens in London, New York, or Tokyo.

After all, between February and August of this year alone, the cumulative losses in shareholder value arising from these various moves approximated USD $1.1 trillion wiped from the market value of China's top six technology stocks alone, including Alibaba, Tencent, and JD. And that number excludes losses to the education, transportation, food delivery, entertainment, and video gaming industries. In particular, we have not yet taken into account the market impact of Xi's decision last month to restrict gaming hours of school-aged children to three hours per week.

The bottom line is that in all these decisions, and in Xi Jinping's hierarchy of policy needs, questions of politics, security, and ideology come first, whereas the interests of investors, analysts, and corporations like the ones I've just listed come last.

So what is the nature of the overall "red thread" that I have referred to? The best way to summarize it is that Xi Jinping has decided that, in the overall balance between the roles of the state and the market in China, it is in the interests of the Party to pivot toward the state.

In doing so, it reflects Xi Jinping's wider worldview on the role of the Party, the state, and the market in the transformation of modern China into a global great power, but a great power in which the Chinese Communist Party nonetheless retains complete control.

What we have seen since 2012 at the beginning of his first term is Xi Jinping progressively moving the center of gravity of Chinese politics further to the left.

What we have seen during Xi Jinping's second term since 2017 is evidence of a parallel move toward the left on the Chinese economy.

Indeed, both these moves have occurred at a time when Chinese nationalism has moved further to the right, as China has prosecuted a more nationalist, assertive and confrontational foreign policy — not just in its own region but around the world.

Some may object to the use of the terms "left" and "right" in this context, but I use them advisedly.

In Chinese politics, for example, we have seen this move to the left in the reassertion of the power of the Party as an institution over the policy, technocratic, and administrative agencies of the Chinese state; just as we have seen the re-empowerment of the Party within both Chinese state-owned corporations and private firms; as well as the return of Marxist-Leninist ideology as a respected organizing principle for both politics and wider public policy.

At the same time, within this shifting center of gravity in Chinese politics, we have also seen Xi Jinping's success in entrenching his own position as China's paramount leader. This has occurred at the expense of the Dengist principle of collectivist leadership put in place in the decades following the Cultural Revolution.

As for the economy, this move to the left has been reflected in a number of specific domains:

- The reassertion of Chinese industrial policy led by the state across all branches of technology;
- The reinvigoration of state-owned enterprises more broadly as a dominant player in the Chinese economy (and now empowered to take extensive equity in Chinese private firms as part of Xi Jinping's so-called "mixed economy model"); and
- Xi Jinping's chiding of China's private entrepreneurial elite for not being sufficiently patriotic when what the Party requires is a brigade of Chinese corporate leaders walking in partnership with the Chinese state and under the ultimate direction of the Party.

As for the third part of my argument (that the movement to the left in Chinese politics and the political economy has been accommodated by a parallel shift to the right on Chinese nationalism, foreign policy and strategic policy), all analysts of Chinese politics and policy would agree that Xi Jinping's recourse to nationalism through the propaganda apparatus is much greater than his predecessors; just as analysts would agree Chinese international policy has become measurably more assertive around the world over the last seven years.

My argument is that none of these things have happened by accident. They have, by and large, occurred as a result of a change in China's overall strategic course — through what Xi Jinping himself lauds as "top-level design" (or "*dingceng sheji*"), an approach which also happens to sit comfortably with Xi Jinping's personal style.

The international analytical community, and certainly the investor community, seem to have ignored Xi Jinping's pronouncement at the 19th Party Congress in 2017 that under his leadership, China had entered into a genuinely "new era" (a "*xin shidai*"). Indeed, within the ideational schemata of Xi Jinping's new era, we are now in a third new age of Chinese Communism:

- The first was the Mao Zedong era through until the end of the Cultural Revolution, when China "stood up";
- The second was the Deng Xiaoping era which ran from 1978 for another 40 years until the 19th Party Conference in 2017, when China, having "stood up," had now "become rich"; and
- The third, the Xi Jinping era, beginning in 2017, is when Xi Jinping says that China, having stood up and become wealthy, must now "become powerful."

Indeed, in Xi Jinping's worldview, his definition of new era of Chinese power is not just a simple question of semantic differentiation from his predecessors. He intends for it to be a substantive differentiation.

So much so that the same 19th Party Congress in 2017 also commissioned a new ideological orthodoxy to help navigate this new era, entitled "Xi Jinping Thought on Socialism with Chinese Characteristics for the New Era."

"Xi Jinping Thought" is now applied to every domain of political theory and public policy. And most recently, it has also been incorporated into a new textbook for Chinese school children.

For these reasons, we should not underestimate the significance of the political and policy changes of China we are now living through.

If there is a central organizing principle in all the above, it is the return of the Party to a central position in Chinese politics, economics, and international policy — and within the Party the absolute centrality of Xi Jinping as the Party's "core leader" — and the resuscitation of the Maoist concept of "struggle" as the only effective means through which to bring about change.

The drivers of recent economic policy change

Beyond this broad trend toward the left, we also need to understand the fundamental driving forces at work in bringing about the particular changes in economic policy that we are examining in this lecture. I argue that there are three of them — ideology, demography, and economic decoupling from the United States:

1. First, the formal changes in the Party's ideological framework outlined in the 19th Party Conference in 2017;
2. Second, the power of demography and the leadership's concern about a population that is aging and shrinking in size more rapidly than it had previously thought; and
3. Third, the impact of decoupling — as Xi Jinping seeks to organize a form of decoupling from the United States on China's terms, before having one imposed on him by the United States, given China's net assessment that U.S. domestic politics will become more hostile to China over the decade ahead rather than less.

The impact of ideology

Foreign analysts often underestimate the importance of Marxist-Leninist ideology within the Chinese political and public policy process. Ideology has been a fundamental component of the Communist Party's life and work since its founding 100 years ago this year. But equally, across that hundred years, Marxism-Leninism has evolved in its meaning. Just as the importance of ideology itself as a guide to political action has also evolved with changing political seasons.

For Chinese practitioners, Marxism-Leninism has three core components: historical materialism (which identifies China's place in a determinist economic development cycle from slave-owning societies, through feudalism to Capitalism, Socialism, and then Communism); dialectical materialism (or the analysis of opposing forces of action and reaction in any given period of economic history that, if properly harnessed, advances society in the ultimate direction of Communism); and third, the "theory of contradictions" (which seeks to identify precisely the predominant force at work in driving change, among all these dialectical forces, to which the Party should therefore address its primary attention).

This will seem arcane to most people. But within what the British sinologist Kerry Brown rightly calls the "band of meaning" that is represented by ideology within the internal discourse of the Chinese Communist Party, it is this shifting definition of the

Party’s “principal contradiction” which ultimately determines what the Party’s political direction is at a given time.

In the Communist Party’s official worldview, having established the new China in 1949 (and then having eliminated, often physically, what it deemed to be the “counter-revolutionary class”), it then proclaimed that the Party’s “principal contradiction” had changed from one of “class struggle” to one of “economic development” in order to lift the people out of poverty.

Again, according to the Party’s official periodization, Mao’s error was to ignore this decision by the 8th Party Congress in 1956 and continue to prosecute class struggle as the Party’s primary focus right through to the end of the Cultural Revolution in 1976.

Then, at the Party’s 12th Congress in 1982, Deng Xiaoping, by then politically ascendant, redefined the Party’s “principal contradiction” once again as economic development. Deng, in fact, went further. It will be recalled that at the time the slogan he was famous for was “to get rich is glorious.” He also said it didn’t matter if some people in some regions became rich earlier than others.

Both in ideology and then, as a result, in practical policy terms, he authorized a new era of market-based economic reforms necessary to “unleash the productive forces” within the Chinese economy irrespective of the consequences that might have on what Marxists call the “relations of production” or class structure.

Deng’s redefinition of the Party’s “principal contradiction” in support of untrammeled economic development would remain in place for another 35 years — between the 12th Party Congress in 1982 until the 19th Congress under Xi Jinping in 2017.

Xi Jinping’s ideological adjustment to the Party’s “principal contradiction” in 2017 on the surface of it seemed subtle. Deng Xiaoping’s era of economic development was not attacked. Indeed, it was acknowledged as being foundational to Xi Jinping’s new era: i.e. the period of reform and opening under Deng had generated sufficient wealth in China through the absolute priority he had attached to economic development to now enable Xi Jinping to do two new things.

First, to deal with the problems of “unbalanced development” and second, to deal with the problems of “inadequate development.”

This seems unremarkable at one level. But beneath the surface, the ideological significance of this change was profound. It ideologically authorized the political and policy apparatus of the Chinese State to adopt a more radical approach to resolving the problems of capitalists excess creased during the Deng period including:

- Income distribution;
- The adequacy of public education;
- The adequacy of public health;
- The adequacy of retirement income; and
- The need to deal with the massive negative environmental consequences of China’s untrammeled economic development over the past decades.

More broadly, the 2017 Party Congress also authorized a re-energized Party to intervene in the economy in order to bring about a range of other political and social policy objectives.

In other words, the 2017 Congress represented the ideological justification for "the pivot to the state" which is the title of this lecture.

Nick Lardy, for example, from the Peterson Institute, described this in 2019 as "the state strikes back" in his book of the same name. Others in the specialist analytical community have been tracking these developments for some time. Indeed, I've been writing on them myself for the past three years and posing questions as to where this ideological change would ultimately land the substance of Chinese economic policy, as well as what the impact of policy change on China's real growth numbers in the medium to long term.

The impact on economic policy direction – market or state?

So what did this ideological change, engineered at the 19th Party Congress, actually bring about in terms of shifts in real-world economic policy?

Deng Xiaoping's period of "reform and opening" from 1978 to 2017 unfolded evenly across a number of different phases — but the central economic policy debate through this period invariably boiled down to a single phrase: i.e. what was the role of the market or the state in the ultimate allocation of economic resources.

Indeed, year after year, Congress after Congress, the fight would be had between economic conservatives and reformers over this central principle as the tide was gradually rolled back over time against the state and in favor of the market.

Ironically, this internal ideological debate appeared to have reached its concluding point in 2013 (already just into Xi Jinping's term) when the relevant Party plenum concluded that the market henceforth would play the "decisive" role in the allocation of resources within the economy. The Chinese term here is "*juedingxing*."

What many analysts failed to note carefully, however, back in the 2013 plenum decision was that the same endorsement of the market playing a decisive role in the economy was balanced in the following paragraph by an official conclusion that the state would also continue to play a major role. In other words, this was not a clear-cut win for market reformers. It was, at best, a win on points for the market — or perhaps even a nil-all draw.

In the lead up to the 2017 Party Congress, the political impetus to implement the reformist decisions outlined in the 2013 plenum had already begun to ebb away.

Indeed, in the Asia Society Policy Institute-Rhodium Group's joint analysis of the implementation of the 60-part reform program embraced by this plenum, we concluded, based on the data alone, that of the ten major baskets of reform outlined in 2013, there had been either zero progress or actual policy regression in most of these by 2021.

One critical factor which undermined Xi Jinping's confidence on the 2013 reform program (under the rubric of the market now playing a decisive role in the economy) was China's real-world domestic financial crisis of 2015 when asset bubbles finally burst, stocks lost nearly half of their value and a state-orchestrated bail-out of the market failed miserably.

This crisis served to reinforce Xi Jinping's underlying ideological skepticism about the supremacy of markets over the instrumentalities of the Party and the state.

I suspect that Xi Jinping's political strategy after the 19th Party Congress in 2017 was to gradually introduce a range of policy measures which would temper market excess over time.

But as with his experience of the stock market crash of 2015, unfolding economic events in the real world would soon create a new reality which Xi had to contend with.

These included the political and economic impact of:

- First, the U.S.-China trade war of 2018-19, Trumpian protectionism, and the incremental unravelling of globalization that we began to witness at the time;
- Second, the COVID-19 pandemic which ravaged China in early 2020 and then the rest of the world since then; and
- Third, Xi Jinping's conclusion that the United States under Biden was unlikely to change its strategic course on continued decoupling from China.

The cumulative impact of these major macro-developments in the years following the 19th Party Congress in 2017 was to cause Xi to conclude that his best bet for navigating this complex future was through stronger, not weaker, Party and state leadership of the economy.

This of course only served to reinforce Xi's pre-existing inclinations toward greater Party control that had already been demonstrated in his root-and-branch approach to political and Party reform during his first term.

Xi, by every instinct, is a centralist, not a devolutionist.

The question then arises as to how this ideological change in Xi's way of thinking about the Party, the state, the market, state-owned enterprises, and private entrepreneurs has been reflected in overall policy terms. That is where we need to reflect on Xi's New Development Concept, his concept of the dual-circulation economy as well as his ideas, now rapidly advancing, concerning common prosperity.

The New Development Concept

The ideological core of Xi Jinping's New Development Concept, referred to in the introduction, is a greater and growing role for the Party and state. Not just as regulators of economic activity. But also as direct economic participants through state-owned enterprises, state investment funds, as well as China's predominantly state-owned financial sector (which of itself can direct the flow of capital across the economy.)

While the term “New Development Concept” itself first began appearing in the Chinese official literature several years ago, it only acquired concrete meaning over the course of the last year.

Importantly, just as the phrase “reform and opening” became emblematic of Deng and his immediate successors Jiang Zemin and Hu Jintao, Xi Jinping’s “New Development Concept,” as of 2021, was beginning to become the substitute banner term.

Whereas the phrase “reform and opening” in itself indicated a particular policy direction toward greater reliance on markets both at home and abroad, the “New Development Concept,” while neutral as a term in itself, is gradually being imbued with a new set of more “statist” meanings instead.

The best way to understand these new meanings is to see them as an accretion of Venn-diagrams: sometimes intersecting, sometimes overlapping, other times not, but within the overall framework of a Party now empowered to intervene whenever it wants.

One of the component parts of the New Development Concept is Xi’s continuing reference to and preference for “the real economy” or “*shiti jingji*.”

While rarely defined in absolute detail, the official commentariat refers to manufacturing, agriculture, merchandise trade, and concrete consumer services as the “real economy” — in contrast to “fictitious economy” sectors that produce little of material value, such as property speculators, technology platforms and the “reckless capital” of the financial firms that enable them.

Within this frame, the real economy by definition provides real jobs with proper conditions and which service the real needs of low- and middle-income Chinese, whereas the fictitious economy (including the gig economy) produces poor employment opportunities, low wages, exploitative working hours and with only limited benefit to consumers.

This is sobering messaging from the political system to the new economy.

Second, there is Xi’s concept of the “dual circulation economy” which is usually defined as moving the Chinese development model from its reliance on labor-intensive, low-wage, exports to a model which is dependent on domestic consumer demand, higher value-added exports plus higher quality imports.

The logic of the dual circulation is that the internal circulation of the economy, based on rising domestic consumer demand, will render China less vulnerable to external economic shock in the future.

Furthermore, the size and sophistication of China’s domestic demand will also result in greater foreign dependency on the Chinese market for the future success of those foreign firms, whether they be in the goods or services sectors.

Moreover, in the classic articulation of the dual economy formula, the Party explicitly emphasizes that the domestic is the dominant part of the model rather than the foreign component.

And the idea of increasing Chinese capture of foreign firms is also explicitly acknowledged in the Party's official literature, including by Xi Jinping himself, who described the goal as in part transforming the Chinese market into a "huge gravitational field attracting international commodity and factor resources." This would help force the rest of the world to engage with China on Beijing's own terms, or risk falling behind commercially.

A third element of the New Development Concept is Xi Jinping's recourse to the language of national self-reliance, or "*zili gengsheng*," which literally means "to rejuvenate through one's own strength."

Prior to the 2017 Party Congress, the term "self-reliance" was not commonly used. When it was used, it tended to be restricted to elements of domestic food supply, energy supply, and high technology (as, for example, articulated in China's "Made in China 2025" strategy, which was first released in 2015).

But by 2020, national self-reliance had taken on a much wider meaning. For example, in April last year, Xi Jinping called for: "killer technologies," the enhancement of high-speed rail, electronic power equipment, new energy, communication among other industries, as well as the development of "independent and controllable, safe and reliable domestic production and supply systems which... can do self-circulation in critical moments to ensure the normal operation of the economy in extreme circumstances."

To give effect to this national self-reliance strategy, Xi Jinping has now appointed Deputy Premier Liu He to run an effort with USD $1 trillion in investment funding aimed at helping Chinese semi-conductor manufacturers overcome current and potential U.S.-led sanctions.

A fourth component of the New Development Concept is a broader role of state-owned enterprises themselves. Prior to 2017, and in particular prior to 2012, the future of Chinese state-owned enterprises was in some doubt, unless they radically purged their debt structures, rationalized their assets and downsized their employment numbers, thereby getting rid of large numbers of zombie enterprises and zombie jobs.

However, since 2017, there has been a renewed emphasis on the role of state-owned enterprises across the board — both as enterprises in themselves, but also through a new set of emerging state investment funds enabling SOEs to expand their operations, invest in private companies or even merge with them.

This is all being done now under the rubric of an SOE reform described as "the state management of capital" rather than simply the "state management of assets."

Its net effect is that over the last several years, the SOE sector has been brought back from the dead, and has once again become a significant economic player in China's overall economic structure — certainly as significant as the private sector, and by some official accounts, much more so.

A fifth element of Xi Jinping's New Development Concept is the unfolding debate on "common prosperity." If the previous four elements have dealt in part or in whole with the future of Chinese industry policy, Xi's common prosperity initiative prioritizes household income policy and, in particular, income redistribution.

For example, the readout from the August 2021 Central Financial and Economic Affairs Commission was that the Party has now "pledged to narrow the gulf between rich and poor and reform income allocation by adjusting excessively high income," crack down on "illegal gains" and encourage high-income groups and enterprises to "give back more to society."

The Party has justified this approach by saying it wants to encourage more people to get rich and to promote more people from lower-income levels to middle-income levels, and to encourage wealth creation through hard work and innovation (as opposed, we presume, to speculation).

And to give visual imagery to Xi Jinping's vision of what common prosperity might look like, Xi said he wanted to see "an olive-shaped distribution, where the middle is large, and the two ends are small."

Right out of the blocks, the People's Bank of China on 20 August stated that "[we must] make promoting common prosperity the starting point and focus of all financial work."

Some of China's largest corporations then began creating large-scale common prosperity, philanthropic funds in the tens of billions (of dollars, not yuan).

At its core, common prosperity seems targeted on using income distribution to lift real wage levels for China's working and middle classes, thereby enhancing the capacity of Chinese workers to become bigger and better consumers in the future, augmenting Xi's new "dual circulation economy" as a result.

But in political perception, and in intention, it is also a clear crackdown against what the Party sees as obscene levels of personal wealth.

As we can see, therefore, Xi Jinping's New Development Concept is an evolving reality. It is difficult to give it a precise conceptual definition.

However, the meta-principles have already become clear: mainly that the days where the market can justify any involvement by firms are over; that it is no longer simply a question of firms not bribing public officials that is important; but that it is now the role of the Party to directly intervene in the economy — to roll back private monopoly, to begin enforcing better wages and conditions in the gig economy and to build a new breed of state-owned (or co-owned) national product champions for the future.

It is, by definition, a pivot to the state.

Demography and China's destiny

I said before that there were a number of factors driving economic policy change in China. The re-definition of the Party's ideological trajectory under Xi Jinping has been one of them, as Marxist-Leninism re-emerges from the shadows to the center stage of the Chinese political economy debate.

Another, however, is demography. It is increasingly clear that China's leadership is becoming seized by the seriousness of China's date with demographic destiny — the rapid aging of the population, the increasing age dependency ratio, and the shrinking of both the workforce and the population at large.

Xi Jinping's "China Dream" had two central pillars: one for China to achieve middle-income status by the centenary of the Party's birth in 2021; the second for China to achieve advanced economy status by the centenary of the PRC's founding in 2049, when China is to reach advanced economy status and be recognized once again as a global great power.

Xi's deep concern is that the likelihood of China becoming a global great power could well be undermined if population growth collapses and the country's public finances implode through the crushing burden of the retirement income, aged care, and health budgets because of an aging population.

In other words, the deepest fear amongst China's legion of long-term planners is that the Chinese nation becomes old (even too old) before it becomes either wealthy or powerful.

This level of concern has already been reflected in the rapid relaxation of China's previous one-child policy over recent years.

China's 2021 census reveals that birth rates have fallen sharply. The number of births in 2020 was down 18 percent on births in 2019. While this can partly be explained from the impact of the pandemic, COVID-19 does not explain it all.

China's fertility rate now stands at 1.3 — lower than China's desired target of 1.8 set in 2017, lower than even Japan's at 1.4, and certainly lower than America's at 1.7 in 2019. The age dependency ratio is already 42 percent and now rising rapidly. China's working population already peaked in size in 2011.

And there is an active debate now among demographers as to whether China's total population might already have peaked in 2020, rather than as previously expected, much later in the coming decade.

For Xi Jinping, these statistical data points, and the dynamics they represent, trigger deep concerns about the future of China's national wealth and power.

Polling data already indicates a serious reluctance on the part of Chinese women to have more than one child simply because it is now unaffordable.

It is calculated that Chinese families now spend an average of USD $115,000 per child from birth to the age of 17 (that is, before college costs) on their children's basic education needs, according to one study.

Indeed, a large part of costs to families is being accrued as a result of large payments to private tutorial firms specializing in the K-12 bracket. It's estimated that some 70 percent of families in China's metropolitan areas use private tutoring services and that these payments take up an average of 12 percent of a parent's income.

Beyond these factors, the employment dynamics of China's gig economy, as indicated earlier with its uncertain hours and highly variable remuneration, compounds the sense of family-level economic uncertainty.

And, under these circumstances, parents are highly reluctant to consider larger families —particularly as many of them have become acculturated to the one-child family over 40 years of vigorous implementation by the state.

Therefore, when we seek to understand why Xi Jinping is now moving on his new common prosperity agenda, his crackdown on the education sector, as well as the employment practices of China's new economy, it is also grounded in his administration's underlying concerns about China's current demographic direction.

In other words, changes in Xi Jinping's policy course in a more interventionist direction have not just been the product of a realignment of Party ideology.

Demographic trends have also been part of the political and policy mix.

Economic decoupling

A third dynamic at play in Xi Jinping's new economic policy direction lies in his concerns about the real-world prospect of economic decoupling from the United States.

I have written in recent years that the term "decoupling" embraces within it multiple different complexities: the decoupling of trade in goods and services; the decoupling of foreign direct investment; the decoupling in global technology markets; the decoupling of financial markets writ large; and, in particular, the longer-term decoupling of currency markets in the long-running, undeclared race between the U.S. Dollar and the Chinese Yuan for domination.

Against any measure, the current state of "decoupling" is uneven. On trade, the tariff barriers between China and the United States are already formidable, and are unlikely to be relieved. And although China's bilateral trade surpluses have continued to grow with the United States, the medium- to long-term prospects for any further round of trade liberalization appear remote.

Foreign direct investment in each other's economies has already contracted to relatively insignificant levels when compared against the national and global quantum of foreign direct investment for each country — both in stock and flow.

In technology markets, the barriers China has encountered in a range of critical technologies (most particularly, in certain categories of semiconductors) have been real and may well be tightened further in the future.

As for capital markets, actions by both Chinese and American regulators concerning listings on their respective stock exchanges are an early indicator of where things may well go in the future. And on this score, it's important to remember that there are, apart from Didi, another 281 Chinese firms currently listed on U.S. markets.

On currency markets, China continues to roll out its digital yuan, and there are reports the United States may well follow suit soon on a digital dollar.

It has been the historical enmeshment between the Chinese and American economies which has insulated the relationship during previous periods of geopolitical tension from spiraling into crisis, conflict or even cold war.

In other words, the mutual economic costs were judged to be too high.

And furthermore, it was judged that widespread mutual economic engagement opened multiple alternative channels of communication between the two countries, which would always militate against the predilections of the security and intelligence establishments in each capital.

However, with the continued unraveling of the U.S.-China economic relationship, combined with financial market reactions to recent regulatory changes in Beijing, the economic ties that have traditionally bound the two countries together are becoming deeply frayed.

In Washington, it has often been assumed that decoupling continues to be a discretionary policy decision for the United States alone for the future. That is, the United States could choose to decouple from China whenever and in whatever areas it chose.

However, the emerging reality is that Xi Jinping's administration has already concluded that this is what the U.S. administration will continue to do (under Biden, but just as they had done under Trump).

Therefore, there is more and more evidence that Xi Jinping (without declaring it as such) has begun to incrementally decouple his own economy from that of the United States.

In other words, the underpinning strategic logic is that Xi Jinping does not intend to be placed in the same position as he was in 2018-19 when the Trump administration began to crush Huawei, China's global 5G strategy, as well as the future of its industry's overall need for foreign-sourced semi-conductors.

More broadly, the change in the tone and content of Xi Jinping's public language has been profound.

In 2019 Xi began talking about a period of protracted struggle with the United States which would extend through until mid-century.

In 2019 and 2020, Xi Jinping began emphasizing the term "struggle" on multiple occasions in referencing the challenges China now faces with an increasingly adverse international political and economic environment.

Then in 2021, Xi Jinping doubled down again, only last week calling on Chinese officials to maintain a fighting spirit and strengthen their ability to struggle; calling on them to "to discard wishful thinking, be willing to fight, and refuse to give way," rekindling the fighting spirit that the Party had demonstrated in the past through great periods of adversity.

The nationalist theme, which is increasingly evident across Xi Jinping's speechmaking, appears to be a direct product of Xi's response to China's changing international circumstances.

In other words, Xi is concluding that the United States, whatever it says, is now determined to isolate the Chinese economy and that China had therefore better be ready for that contingency.

This much is evident in Xi's notion of national self-reliance, the dual circulation economy, and the cybersecurity of China's major technology platforms, as well as his deep concerns about the future trajectory of China's demography.

On cyber alone, for example, Xi has gone further than before with a new data security law that provides for the investigation of data processing activities inside or outside of China that may "harm the national security, public interest or legal rights and interests of citizens or organizations of the PRC."

As Xi Jinping has stated: "without cybersecurity, there is no national security."

Beyond Xi's nationalist concerns for his country's future economic resilience, Xi has also authorized a wider social policy campaign to build up the moral fiber of Chinese youth.

I've already referred to his decision to limit gaming for students to three hours per week. This has been accompanied by semi-official blogs urging Chinese parents to ensure that their sons are brought up in an appropriately masculine environment so that no room is left for "effeminate sissies." These unofficial campaigns across Chinese social media have only just begun, but have also bled out into new restrictions facing China's large LGBTQ community.

All this is now to be addressed in the classrooms of China with a solid dose of Xi Jinping Thought — reinforced by new Xi Jinping Thought primers, one of which goes under the snappy new title of "Happiness Only Comes Through Struggle."

Impact on China's economy: growth, innovation, and productivity

Understanding what Xi Jinping is now seeking to do in his overall economic policy direction is one thing.

Understanding why he is doing it is another.

Understanding what impact it may have in the real economy of the future is perhaps the most important of all.

It is the possibility of economic failure that represents the most pressing political threat hanging over Xi Jinping's head in the critical decade ahead — the decade likely to determine the future balance of power between China and the United States.

Xi's most recent gambit to "pivot to public" on the economy is fundamentally a political one.

These include the focus on "common prosperity" by reducing income inequality, achieving national technological self-reliance, and most importantly embracing state leadership over the market at most levels of the economy.

In Xi's vision, this will simultaneously win over "the people" to his side, reduce China's vulnerability to external pressures, and provide a robust new driver for the sustainable growth of China's "real economy" far into the future.

This is, however, highly optimistic. Casting aside the proven growth engine of China's recent economic transformation — the private sector — in favor of more centralized control of the economy risks stunting China's growth momentum at the most critical time.

Indeed, there are signs that private fixed capital investment has already begun to lag, reflecting declining levels of private sector confidence.

Already, China's economic growth is beginning to slow.

While Chinese GDP posted a strong 18.3 percent early recovery from the pandemic in the first quarter of 2021, growth then slowed to 7.9 percent in the second quarter – well below expectations.

Additionally, recovery in industrial production fell to 8.9 percent in the second quarter, marking a significant drop from the 24.5 percent logged in the first.

The slowdown signaled a halt to a hoped-for V-shaped recovery from the COVID-19 pandemic and hinted at the underlying structural challenges beneath China's economic growth prospects for the decade ahead.

Much of China’s economic growth during 2021 was powered by the longstanding growth drivers of net exports, manufacturing, and government investment. Exports, however, are unlikely to persist as a major growth driver because of disruptions related to the pandemic, the U.S.-China trade war, and global supply chains.

Under Xi’s new development model, as noted above, domestic consumer demand is also meant to drive much of China’s economic growth for the coming decade. But while private consumption has proven to be relatively resilient so far, it is still limited by the country’s culture of high household saving rates.

In general, the future outlook for China’s consumer demand is less than robust. With the income and spending gap between China’s rich and poor widening significantly during the pandemic, it is far from certain that China’s overall consumption growth can maintain previous momentum.

What consumer spending growth there has been is expected to moderate once pent-up demand from the pandemic dissipates.

And while e-commerce has seen relatively strong growth during the pandemic and immediate post-pandemic period, this is precisely the sector where Xi’s anti-monopoly campaign is cracking down hard with as yet uncertain consequences for growth.

Consumer demand is also likely to be undermined by persistent problems with unemployment. The latest official unemployment figures show that China’s surveyed urban unemployment rate stood at around 5 percent in July 2021.

While this is not high (though some analysts speculate the real rate is much higher), it covers up more specific concerns — namely the unemployment rate for 16-24 year-olds which even on the official numbers rose to 13.8 percent. Xi’s crackdown on China’s private sector, which provides for about 90 percent of new employment growth, will only dim them further.

Xi has also focused on state-led innovation through initiatives like the “Made in China 2025” policy that I’ve referred to previously, and its various successor policies. It remains to be seen, however, whether this Beijing variation of the Chinese “military-industrial complex” will succeed like its American antecedents in the 1950s, or whether it will only exacerbate China’s existing inefficiencies in the allocation of capital.

However, it is in overall productivity growth where China’s economy is weakest and faces the greatest challenge in Xi Jinping’s new economic era.

Since 2008, China’s total factor productivity (TFP) has grown by just 1.1 percent annually, less than a third the rate of the previous three decades, according to the World Bank.

During the 2009-2018 period following the global financial crisis, aggregate labor productivity in China weakened to 7.4 percent per year, down from 9.0 percent in the 1999-2008 period before the crisis.

Moreover, of all the sectors that have experienced slowdowns in the past few years, it has been the services sector — precisely the sector Xi is counting on powering the economy — that has been hit the hardest, with productivity falling from 8.1 percent to 4.6 percent over the last decade. That downward trend has persisted as the overall pace of reform has slowed.

Comparatively, China's economy does not yet come close to measuring up against the economies of other advanced countries. China's economy is still only around 30 percent as productive as the U.S., Japanese, or German economies.

Most economists' evaluation of the reasons for this is clear: it lies in the continued size, influence, and unproductive investment of the state sector. While the IMF evaluates productivity at Chinese state-owned enterprises to be only about 80 percent that of private firms, state firms enjoy preferential access to capital from banks.

Economists argue that major state-sector reform to clean out low-productivity firms could more than double annual productivity growth over the next five years from 0.6 percent to about 1.4 percent. This 0.8 percent improvement would also lift overall GDP growth by the same level, e.g. from the IMF's 5.7 percent projection for 2022 to 6.5 percent.

Xi, however, now shows little interest in moving in this direction.

For these reasons, while China is likely to reach its year-end target of 6 percent economic growth in 2021, the era of high growth in China may well be over. Even ahead of Xi's crackdown on the private sector, a consensus has emerged among global economists that China's economic growth will probably slow to around 4 percent by 2025.

This forecast deceleration also reflects China's aging population, declining workforce, weak productivity growth, a negative trade environment, and high levels of official debt.

Now, if we add to this is the as yet unknown impact of Xi's macro "pivot to public" across the overall political economy, to the potential expense of China's hitherto remarkable culture of private sector dynamism, we simply do not know what the net impact on growth might be.

Private sector investment, both domestic and from foreign sources, could well slow further — stranded in a period of great uncertainty between Xi's "Common Prosperity" campaign at home and the threat of U.S.-China decoupling abroad.

For years, economists have warned that only increases in total factor productivity can ultimately save China from the middle-income trap, and that this increase can only come from an economy with less state involvement, not more.

The next decade is likely to determine once and for all whether this hard-won, collective wisdom proves still to be true — or whether China really is *sui generis* in the efficacy of its new, but still unfolding, economic model: Xi's New Development Concept.

If Xi Jinping is fully aware of the economic policy gamble he is taking by changing the model in the midst of unfolding geopolitical risk, it may induce a level of caution about adding further risks to his overall strategic calculus.

But if he is unaware, which may well be the case because of his reported intolerance of official doubt, caution and negativity, compounded by his lack of familiarity with the technical granularity of the economic policy brief, then China may well find itself embarking on a decade of growing international assertiveness at a time when its domestic economy is beginning to weaken.

Conclusion

For these reasons, I believe that right now we are living through a profound change in China's overall economic policy settings.

I also believe that this new economic direction will remain with us at least until the 20th Party Congress due to be held in fall 2022.

It will also be recalled that it is the 20th Congress that will determine whether Xi Jinping is reappointed for a record third term and therefore, most likely, as leader for life.

Whereas the change in economic policy directions that I've outlined today are indeed driven by a combination of ideology, demography, and the perceived risk of decoupling, Xi Jinping also has his eyes set on the politics of 2022.

His political calculus is that by injecting more "socialism" into Deng's "socialism with Chinese characteristics," this is more likely to win him broad-based popular support across Chinese society than not.

In other words, his calculus is that, given the 600 million Chinese who currently live and work on less than USD $155 per month, a more socialist message about income distribution and employment conditions is more likely to enhance his reappointment prospects, rather than the reverse.

Similarly, in dealing with the risk of a U.S.-led decoupling of the two economies, Xi Jinping's economic mantra is also redolent with nationalist flavor, to prepare China properly from externally-generated threats designed to prevent China's otherwise inevitable rise.

It will not, however, be all plain sailing for Xi Jinping over the next 15 months or so. His Achilles' heel will continue to lie in the performance of the Chinese economy. And that, as I indicated earlier, is where Xi is taking a large gamble indeed.

Chinese private sector sentiment is unaccustomed to this level of political, legislative, and regulatory change. Of itself, it is unsettling. Some will see opportunity in it. Many others will see risk and threat.

It’s for these reasons that China’s dwindling band of liberal economic reformers have been out in recent days, weeks, and months, proclaiming the Party’s “unwavering support” for the private sector.

Given the water that’s gone under the bridge since the tumultuous events of last November, I’m not certain that the Chinese private sector is likely to be convinced.

Nor for that matter am I convinced that private fixed capital investment data for the year ahead (the best litmus test of real levels of business confidence) will be robust, if indeed the data is robustly collected and reported.

For Xi Jinping, within the internal world of the Chinese Communist Party, he may well have got the politics right with these most recent economic policy decisions.

But the question remains as to whether he has got the underlying economics quite wrong.

And if the economics does prove to be wrong, and China’s growth numbers are significantly impaired over time, that in turn will have profound implications for long-term global economic recovery from the COVID-induced recessions of 2020 and 2021.

As for the wide, wide world of foreign policy, way beyond the remit of this particular address, the future direction of China’s political economy — irrespective of whether Xi Jinping’s economic project succeeds or fails — all the policy evidence points to a growing policy divide between the Chinese and American economies, rather than the reverse.

Economics, therefore, now appears to be reinforcing rather than remediating the geopolitical chasm that has already opened up between the two countries.

And so now we live in difficult times indeed.