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MERICS Primer

Is this time different? The structural economic reform challenges for Xi's 3rd term

Analyzing Beijing's enduring struggle to achieve progress in five key areas

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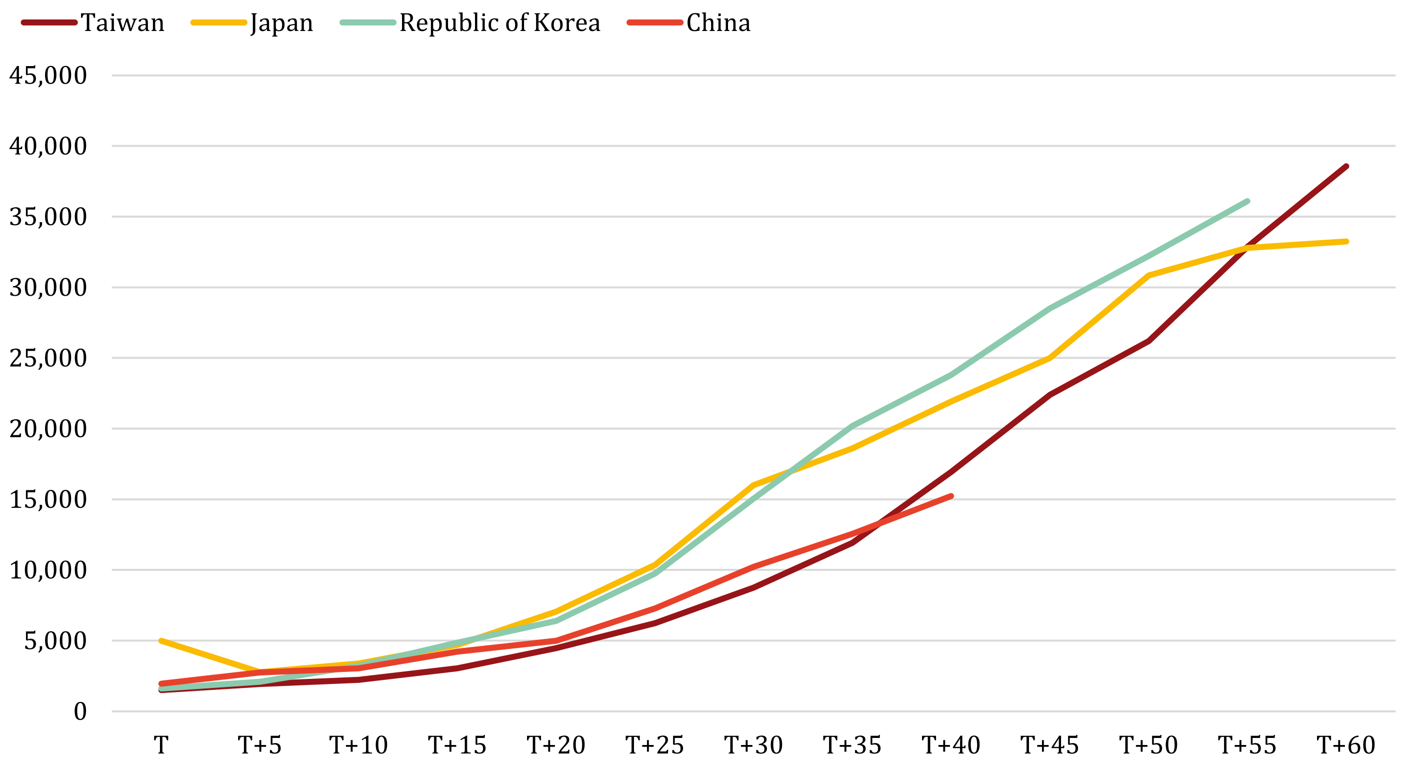
To achieve China's ambitious growth targets, structural reforms are necessary

China's income growth lags behind Japan South Korea, and Taiwan

GDP per capita (PPP adjusted , measured in constant 2011 international USD)



Note: T – introduction of market reforms - is measured as 1941 for Japan, 1951 for Taiwan, 1961 for Korea and 1981 for China. China data for 2018-2021 was inferred from GDP per capita growth rate from the World Bank.

Source: Maddison Project Database; EUCCC, World Bank

What worked to drive growth in the past is yielding increasingly smaller returns

- China has made tremendous strides in its development story: its per capita GDP reached 12,551 USD in 2021 (current USD)
- Still, China's development trajectory is lagging behind Japan or the Republic of Korea at similar stages of development
- While China has managed to pull off some impressive feats in industrial policy (electric vehicles), efforts to resolve structural problems like inequality have stalled
- China has also already picked most of the low hanging fruit (migration of cheap labor from the agricultural sector, late comer advantage)
- To reach its ambitious growth targets for 2035 (average growth of 4.8 percent) China will need to initiate major structural reforms, however growth already slowed to 3 percent in the first nine months of 2022

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Previous structural reforms demanded sustained efforts and vast resources

Zhu Rongji advanced SOE reform by leaps and bounds

- In the 1990s, Premier Zhu Rongji led a flagship effort to advance SOE and market reforms
- Liberalization, though far from complete, managed to break through vested interests and fears of stability alike due to Premier Zhu's steadfast focus
- The process also embraced huge risks to catalyze reforms with the promise of rewards, particularly in how WTO accession was used to advance domestic market reforms

Xi Jinping's anti-corruption efforts yielded more than just political fruit

- Throughout his decade in power, President Xi Jinping has prioritized anti-corruption work at all levels
- Vast resources and sustained focus from Xi himself were successful in drastically cutting back on legitimate corruption, even if at least some of it was aimed at political rivals specifically
- The European Union Chamber of Commerce in China reporting considerable progress — 26 percent of surveyed companies listed corruption as a top three issue in 2014, while only 10 percent did in 2021

But many more to tackle

- Yet, a multitude of structural issues remain in place, holding back China's development
- Many structural issues are deeply intertwined with one another, which will make it difficult to unravel them without major risk and discomfort
- From wealth distribution (both regional and individual) and pension reform support for SMEs and advancing of CNY liberalization, Beijing faces complex challenges that will demand the kind of attention that SOE reform and anti-corruption efforts demanded in the past, rather than the rinse and repeat strategies applied to these challenges again and again

A new round of policies tries (again) to solve long-standing structural problems

Policy objective	1 Reduce inequality	2 Strengthen SMEs	3 Reform the pension system	4 Promote regional development	5 Liberalize capital account
Historic policy	Various Policies e.g. Minimum wage introduction (2004)	SME Promotion Law (2003)	Several measures since 2009, e.g. New Rural Social Pension Schemes	Go West (1999), Rise of Central China (2004)	Qianhai Pilot (2012) / Shanghai Pilot FTZ (2013)
Current policy	Common Prosperity (2021)	Opinions to Promote SMEs (2019)	14th FYP for Human Resources and Social Security (2021)	Dual Circulation Strategy (2020)	Shanghai FTZ (2019)
Xi's 20th Party Congress Report	"The system of income distribution is the foundational system for promoting common prosperity."	"We will support the development of micro, small, and medium enterprises."	"We will improve the unified national management system for basic old-age insurance funds and develop a multi-tiered and multi-pillar old-age insurance system."	"There are still wide gaps in development and income distribution between urban and rural areas and between regions."	"We will promote the internationalization of the CNY in an orderly way."

Source: MERICS

1. Reduce inequality: ‘Common Prosperity’ revived to address old social issues

Various policies to address inequality

Goals: Raise real incomes through economic development

- Since the late 1980s China has introduced several policies to address income inequality, including:
  - Introduction (2004) and subsequent hikes in the minimum wage as well as better enforcement
  - Introduction of a progressive income tax (1981)
  - Introduction of basic welfare in the ‘dibao’ system to alleviate poverty (1999)
  - Abolition of agricultural taxes and fees (2006)

Progress and gaps

- While China has evidently prioritized overall growth over inequality reduction, it still has ambitious targets
- Policies did not reverse high inequality, primarily due to structural factors and vested interests (e.g. urban elites) that benefitted from the status quo
- Nonetheless, overall, China’s policies led to a rise in real wages and China did manage to eliminate most acute poverty, even though income for the poorest remains low

Why does it (still) matter?

Inequality in China, measured by the Gini Coefficient, peaked in 2008 but remains at a high level at 0.468. The UN considers inequality levels above 0.4 as unhealthy. What’s more, demographic factors and urbanization will further increase inequality, unless policy changes occur.

High inequality contributes to a high savings rate, as rich households generally save more than poorer ones, which contributes to a lack of consumption, thus promoting China’s imbalanced and investment-reliant growth model.

High levels of income inequality can also lead to suboptimal health and education investments which further weigh on growth. Crucially, inequality is also a matter for social stability - a top priority for the CCP.

Common Prosperity (CP) (2021)

Goals: Improve income equality to strengthen legitimacy and propel future economic growth

- The CCP has used CP since 1952 as a slogan to highlight the superiority of the Chinese socialist system
- The central government designated the highly developed Zhejiang province as a pilot zone for Common prosperity
- Policy makers have indicated that CP will entail cracking down on illegal incomes and creating more opportunities

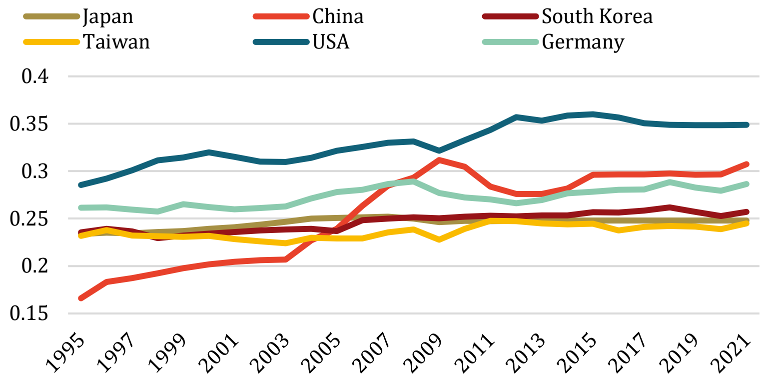
What to expect

- Xi Jinping has adopted CP, which has populist tendencies, to bolster his legitimacy and rebalance the economy
- Concrete policy proposals remain absent and structural factors are not addressed, a European-style welfare system is categorically ruled out as ‘welfare-ism’
- Structural imbalances are widened as consumption and private firms, also due to crackdowns, are on a backfoot

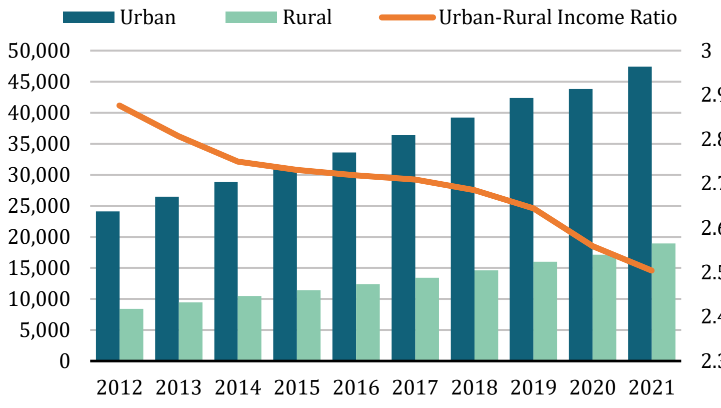
1. Reduce inequality: Trends seem unaffected by Common Prosperity push

Achievement: Inequality levelled off

China's wealth inequality has nearly doubled since 1995
Net personal wealth of top 1 percent of country population, in percent



China's urban rural income gap is shrinking
Annual disposable income per capita in CNY



Source: CEIC

Status: CP – for now largely rhetoric

- **Recognition of inequality is a first step, but Beijing needs to implement reform policies outlined at the 3rd Plenum in 2013.** Pointing out wealth disparities openly is an important signal. But concrete policies that address structural factors are for now absent.
- **For now, CP is not at the top of the agenda.** For much of 2022, President Xi had different priorities with an economy struggling with COVID lockdowns. Now that he has cemented power CP may be meaningfully revived in policymaking.
- **Tertiary redistribution, property tax pilot and improved working conditions are not enough.** China needs to address structural factors to force change. Tertiary redistribution, as in charitable donations by tech giants, will not be enough to solve China's inequality problems. What's needed are policies focused on primary and secondary redistribution to push the Gini index below 0.4.
- **The CP pilot zone lacks ambitious targets.** Zhejiang, a rich coastal province and home to many of China's tech giants, has been chosen deliberately. Still, the pilot's targets are extremely broad and unambitious, insdicating that policymakers are not yet serious about CP implementation.

Structural reform barriers

Vested interest groups oppose greater income equality. Some interest groups, such as urban or CCP elites or provincial governments have successfully lobbied to keep obstacles to greater equality in place. These measures for instance include resistance to hukou reform and higher property taxes. That mainly benefits rich urbanites at the cost of rural Chinese.

China's lopsided-economic structure favors urban centers and coastal regions, perpetuating inequality. Regional and urban-rural differences account for a major proportion of inequality. Wages are much lower in the countryside and non-coastal provinces. While China's top universities allocate a disproportionate number of spots to locals.

China's focus on creating an investment- and export-led economic model exacerbates inequality. Over decades China has suppressed wages and its currency to make its economy more export-oriented and promote businesses. Collective bargaining reform stalled. That has shifted wealth from households to companies, increased inequality and hampered consumption.

2. Strengthen SMEs: China wants its own industrial 'hidden champions'

SME Promotion Law (2003)

Goals: Improve the business environment of SMEs and create job opportunities

- Lays the groundwork for state support for SMEs by improving the market environment and financing
- Outlines fiscal and taxation measure that local government should adopt to support SMEs
- Encourage technological cooperation between SMEs and research institutes and universities

Progress and gaps

- The law was the first comprehensive attempt to strengthen the SMEs after China's reform and opening, this means the support for SMEs starts from a very basic level. Primarily, SMEs are established as a "category" that local governments should foster and support
- Overall, the measures and goals are vague which signals that while the government is generally supportive, it has not yet developed targeted measures to promote SMEs

Why does it (still) matter?

SMEs are small- and medium-sized enterprises (<300 employees), in China they account for 99 percent of all firms.

SMEs are vital for China's economy and future economic growth, which is why the central government is eager to employ them to achieve national goals.

Chinese SMEs contribute to over 60 percent of total GDP, 50 percent of tax income and 75 percent of job creation.

China is also looking to SMEs as vital players in its self-reliance drive. According to Beijing, high-tech SMEs should focus their efforts to close China's technology gaps.

Opinions to promote the healthy development of SMEs (2019)

Goals: Develop SMEs into innovative growth engines and tech suppliers

- Strengthen SMEs through improved financing, beneficial fiscal policies, strengthened innovation capabilities, an improved SME service system (Beijing Stock Exchange), and party guidance
- Encourage large firms and SMEs to cooperate on R&D
- Promote promising tech-focused SMEs as part of the Little Giant Initiative

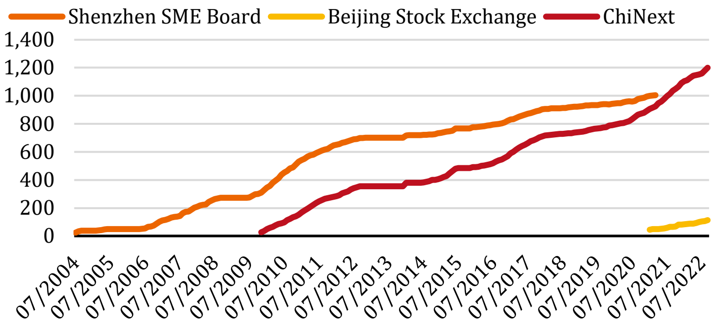
What to expect

- SME support has become more targeted, and focused on innovation and filling technological bottlenecks
- SME promotion takes place in the context of high-level national strategies such as Made in China 2025, and technological competition with the US
- Still, structural factors that allowed Germany to foster its "hidden champions", such as efficient vocational systems, remain absent in China

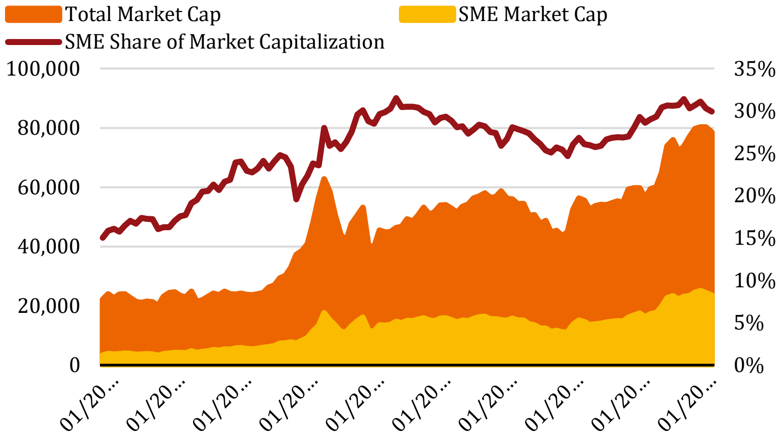
2. Strengthen SMEs: Vested interests undermine private sector promotion

Achievement: SME financing improved

New stock exchanges offers financing opportunities for SMEs
Number of listed SMEs



SME equity financing increased over the last decade
Market capitalization in CNY billion, percent share



Note: In 2021, the Shenzhen SME Board was merged with the Shenzhen Main Board.
Source: CEIC

Status: Beijing wants 'Hidden Champs'

- **China wants to emulate Germany's 'hidden champions.'** China wants its so-called 'Little Giants' to replicate these highly specialized, globally active firms with high market shares in niche sectors to promote its economy and push for tech self-reliance.
- **Becoming a Little Giant is highly beneficial.** Provincial Governments propose local SMEs to the MIIT and MOF for approval. If chosen, based on the SME's profitability and them being active in targeted sectors, they will receive state support and easier access to finance.
- **The Little Giant policy indicates that China can leverage its state-controlled banking system to promote industrial policy.** The List of Little Giants is essentially a signal to banks and private investors that lending and/or investing into these companies is encouraged.
- **This has costs: Being classified as a little giant might become necessary for SMEs to succeed.** It will become harder for Chinese SMEs to compete purely on economic terms. They need vetting by local and central government authorities ("Little Giant credentials") to receive full access to state support. Companies will need to fulfill political rather than market demands.

Structural reform barriers

The Chinese government favors SOEs impeding SMEs. Most SMEs are privately owned and the political bias towards state-ownership, for control purposes, hinders their development, e.g. for market access or financing. By aligning themselves with national goals rather than only market demands, some SMEs can access state support.

China's state-run banking system remains supportive of vested interests. By further chipping away the implicit guarantees by local and central governments towards SOEs, and giving way to a stronger focus on risk, SMEs could gain easier access to finance. This has become more urgent as derisking efforts have closed informal financing channels.

An institutional bias towards manufacturing drags down SMEs. China's high household saving rate, low consumption rate and focus on investment-driven growth disproportionally weakens SMEs. The overwhelming majority of SMEs is active in consumption-driven sectors, often in services. However, local governments raise revenues from capital-intensive sectors, thus prioritizing industry.

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3. Pension system reform: An ageing populace demands stronger social security

Pension reform (particularly 2009-2015)

Goals: Prevent widespread poverty in retirement and extend pension coverage to the countryside

- New Rural Social Pension Schemes covers rural residents (2009)
- Rural migrants can qualify for urban pension (2011)
- The current pension system has two pension streams: the 'Basic Old Age Insurance' for former urban workers and the 'Urban and Rural Residents Pension Scheme' for urban unemployed and rural populations

Progress and gaps

- The extension of coverage is a major success of China's pension reform. In the 1980s only few people were covered by state pension, now almost a billion people are part of the world's biggest pension system
- However, the extension of the pension system has come at the cost of fragmentation and unequal access to pensions. Also, China's retirement age has not been changed since the 1950s even as life expectancy surged

Why does it (still) matter?

China's pension reform is a success story which now covers almost one billion people.

Still, China's rapidly aging population - by 2035 420 million or 30 percent of the total population will be over 60 years old - aggravates the system's sustainability. Not only are costs getting higher, but the work force is also shrinking. That is aggravated by China's very low retirement age (60 for men, 55 for women in most cases).

China could grow old before it becomes rich. In addition, the system promotes income inequality. Rural pensions remain below urban pensions by a factor of 20. That prolongs poverty and is a drag on consumption and economic growth.

14th Five-Year Plan for Human Resources and Social Security (2021)

Goals: Make the pension system more financially sustainable and make first steps towards greater income equality

- Raise the statutory retirement age in a phased manner
- Develop a multi-tier, multi-pillar pension system
- Gradually raise the pension standard (urban + rural)
- Set up a national coordination mechanism to strengthen the central transfer of funds (Central Adjustment Fund)
- Transfer more state-owned capital to fund pensions

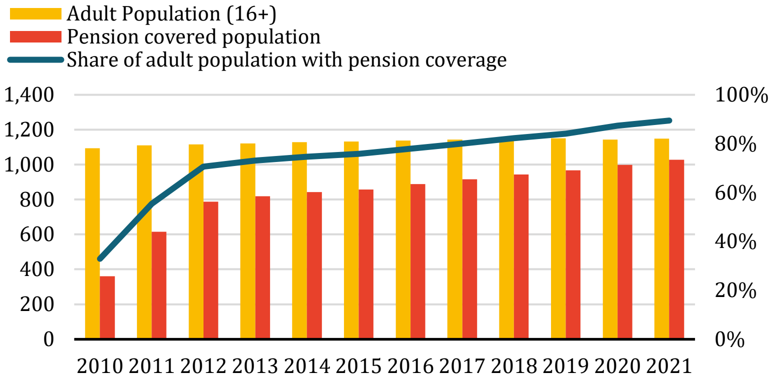
What to expect

- The plan clearly illustrates Beijing's struggle between ensuring sustainable finances and promoting equality. For now, sound finances are the top priority, alleviating urban-rural division will be tackled later
- Raising the retirement age has been proposed before, but as the pension system's financial burden increases implementation is becoming more likely. Once GDP growth has stabilized expect policymakers to strike

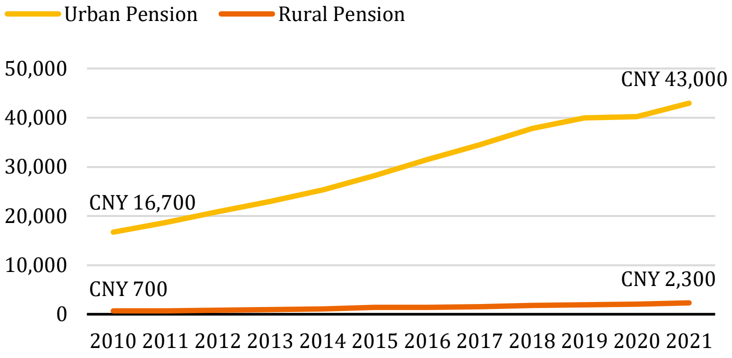
3. Pension system reform: Financial unsustainability threatens progress

Achievement: Wide/unequal coverage

Pension reforms have led to high pension coverage
Population in million (left), share in percent (right)



Rural-urban income inequality is aggravated in retirement
Annual pension income in CNY



Source: CEIC

Status: Beijing prioritizes finances

- **The reforms outlined in the 14th FYP signal that pension financing sustainability is the primary goal.** In 2018 Beijing set up the Central Adjustment Fund (CAF) that redistributes funds from richer to poorer provinces. The proposal to increase the retirement age is also aimed at making the system more sustainable.
- **Financial sustainability and reducing inequality can go hand in hand.** To stimulate consumption and reduce inequality, Beijing will also need to shift focus towards bridging the urban-rural gap. Increasing rural pensions and reducing the benefit increase rate for urban pensions could reduce inequality and increase financial sustainability.
- **Integrating the urban and rural pension systems has not yet entered the policy realm.** Research indicates that the transition cost to an unified national pension system is moderate, it could help alleviate urban-rural gaps in inequality.

Structural reform barriers

Longevity and low births make the current system unsustainable. Currently, children are expected to financially support their parents. This is a tradition steeped in history and the government has been leaning on it. However, as parents live longer and have fewer children this system becomes increasingly untenable.

The backing of the central government creates moral hazard and agency problems. The interests of local and central governments are not aligned. Rich provinces push back on transfer payments. Provinces also want to increase local payouts and keep costs, for firms, down. They often minimize collections and maximize payouts. Beijing is trying to counteract these tendencies through the CAF.

Limited investment choices and low returns make it difficult to supplement pensions with private savings. China's industrial policy requires huge investments that demand cheap capital. That money comes from Chinese savers who have very limited investment choices, often with low interest rates. This is aggravated by capital controls. This system harbors the risk of making the current system financially unsustainable.

4. Promote regional development: Provincial income disparity still significant

Great Western Development (GWD) 2001, Rise of Central China (2004)

Goals: Halt and rebalance development disparities between western and coastal regions

- Prioritizes central funds and preferential policies for the Western Region
- Raise living standards through several measures, including a) market reforms that incentive private investment b) major infrastructure projects c) greater access for foreign investment d) poverty alleviation and universal education

Progress and gaps

- The WDP is a public demonstration that Beijing recognizes the regional development disparities and wants to address them
- The WDP already indicates a learning process from earlier policy failures, including the "Third Front" program that failed in producing spillover effects
- Focus is on poverty alleviation and industrialization of the Western and Central regions

Why does it (still) matter?

Regional economic inequality and low household consumption have several effects on the economy that the CCP wants to remedy.

Firstly, regional economic inequality can be a drag on consumption, as richer regions are more prone to save, while poorer areas are potentially too impoverished to consume a lot. This also increases China's dependence on overseas consumers.

Secondly, inequality can reflect negatively on the CCP's legitimacy to rule, particularly as the CCP prides itself extracting political outputs for its citizens. Lastly, regional inequality harbors the potential for social unrest.

Dual Circulation Strategy (DCS) (2020), Updated Regional Development FYPs

Goals: Transform China's growth model, by increasing the consumption share of GDP substantially, and strengthening self-reliance by developing backward regions

- Export higher value goods (external circle) and expand domestic demand, mainly increasing consumption (internal circle)
- Power the internal circle by increasing the consumer base in the economically lagging Western regions through preferential investment and improved market access

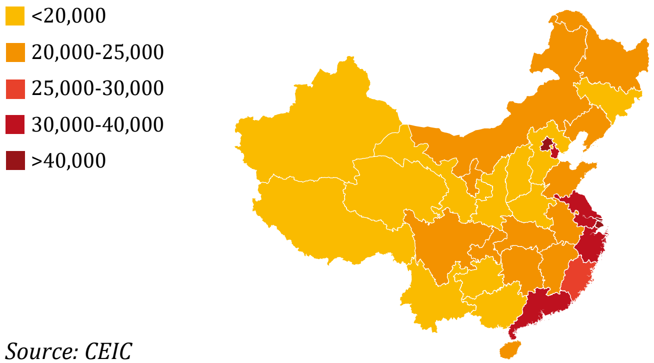
What to expect

- The GWD and other development policies persist and are continuously updated
- Under DCS we should anticipate more of the same, under a new banner, and additional goals including unlocking consumer potential in underdeveloped regions
- This is part of China's self-reliance push, exacerbated due to a more hostile geopolitical environment, which elevates the need to expand China's domestic market

4. Promote regional development: Weak demand-side curbs consumption

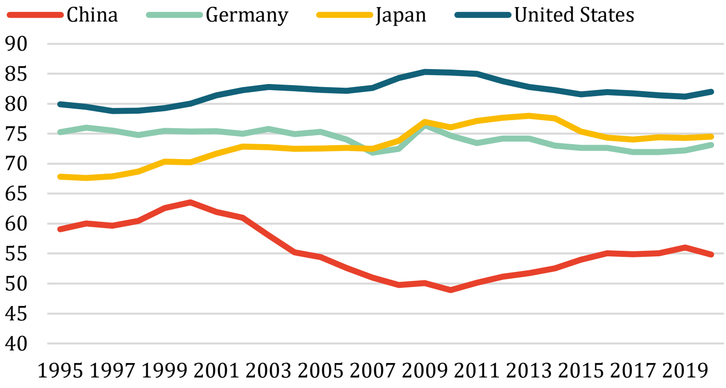
Achievement: Consumption still lagging

Despite two decades of effort, consumption lags in inland provinces
Annual consumption expenditure per capita in CNY (2021)



Source: CEIC

China's Consumption share has increased since 2010, but remains at a low level and with Covid-19 has started falling again
Final consumption expenditure (percent of GDP)



Source: WB

Status: Efforts to boost self-reliance

- **Rebalancing China's economy towards greater consumption has gained new urgency.** The leadership regards the current economic structure, geared towards exports and investment, unsustainable. Rebalancing is not a new objective. Economic, such as ever lower returns on investment, and political factors, a perceived high reliance on foreign consumers, have added urgency.
- **Combatting regional inequality is part of the nation-wide effort to boost consumption.** To expand domestic consumption, China wants to broaden its middle-class and consumer base. In per capita terms poorer Western regions are an essential part of that strategy. China continues to reduce market access barriers for certain investments in Western regions.
- **Still, old targets have not disappeared.** Regularly updated regional development plans still target the same old goals: poverty alleviation, industrialization and improving the business environment.
- **Short-term measures need to be supplemented with structural changes.** Ex. - To boost automotive consumption, MOFCOM and the NDRC have issued measures, including increasing parking spaces and charging piles. That can help stimulate demand in the short-term, but initiatives remain focused on supply- rather than demand-side measures.

Structural reform barriers

High government share of GDP undermines consumption. China's low consumption is underpinned by a low household (55% vs. 70-80% in advanced economies) share of GDP. Without income, households cannot consume. Transfer payments to local governments went towards investment into industrialization or real estate, not households.

Vested interests have led Beijing to turn a blind eye to greater redistribution. While the primary issue at stake is the lack of household share of GDP, high inequality promotes saving over consumption. Redistribution from richer to poorer households has been limited, restraining consumption growth. CP could be the answer, depending on how it plays out.

China's fiscal system remains unchanged – moral hazard issues persist. The WDP and DCS are both campaign-style programs, operating within the status quo. As budgetary resources flow to local governments in the West, incentive structures are potentially worsened. Local governments will try to divert central government funds towards their regions, increasing their dependency on central funds.

5. Liberalize the capital account: Beijing's dream of a USD-challenging CNY

An ambition to challenge the USD (2011-15)

Goals: Development of the basic framework for usage of the CNY in international transactions overseas

- Following the :
  - Higher flexibility of the CNY exchange rate
  - Multiplication of bilateral FX swap by the PBoC
  - Structurization of off-shore CNY market (2010)
  - Openings to purely financial cross border flows
  - The CNY in the IMF reference currency basket (SDR)

Progress and gaps

- The 2007 easing of regulations on cross border flows of the CNY set the stage for use outside of China.
- International usage of the CNY increased but remains stuck at low levels compared to the USD or EUR, instead being alongside the Australian Dollar and Swiss Franc.
- Beijing has displayed a limited tolerance for market forces and volatility in the exchange rate. Without capital account liberalization, global use will remain limited.

Why does it (still) matter?

Beijing's effort to promote internationalization while maintaining capital controls suggests that this campaign is more about achieving geopolitical goals – challenging the USD – than economic ones.

Achieving such an objective would reduce exposure to the extraterritorial reach of US sanctions for China and certain partners. It would also allow Beijing to provide more and cheaper international financing, while lowering its own costs and facilitating its trade transactions.

If CNY internationalization comes alongside some cross-border financial flow liberalization, as expected, it would also improve the overall allocation of Chinese capital, away from overvalued domestic assets such as real-estate.

Spur the CNY's international use (2018)

Goals: Actively incentivize the usage of the CNY, particularly along the Belt and Road

- Clarifies that a regular liberalization of the capital account is not on the table
- Creates well-monitored venues for foreign investors to access deep and complete CNY-financial markets
- Develops new tools and venues for better monitoring the financial exchanges between mainland and international markets

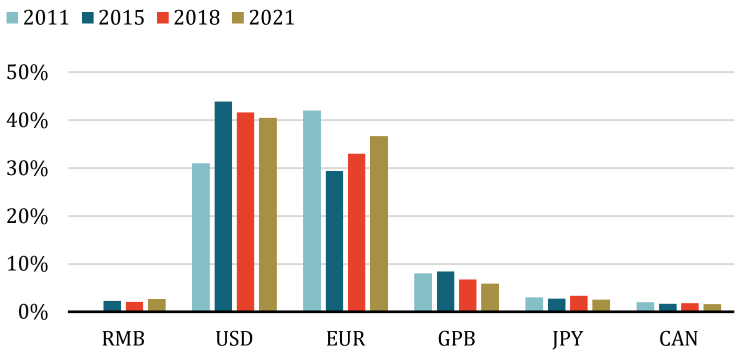
What to expect

- After disappearing from official plans for two years, the policy of CNY internationalization appears more limited in ambition as well as geographic and sectoral scope
- The narrower ambition and the growing economic clout of the PRC will likely lead to some limited successes
- Structural impediments on the usage of the CNY on international markets have not been addressed, and set a ceiling for internationalization

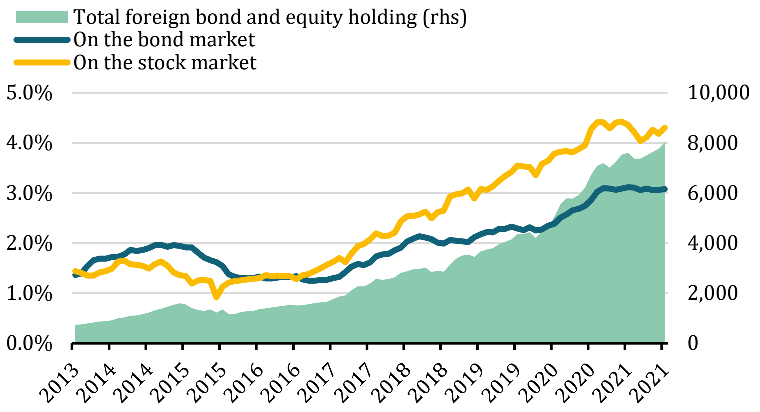
5. Liberalize the capital account: At odds with a quest for stability and control

Achievement: Int. CNY usage increased

CNY utilization in international transactions is up, but marginal
Share of currency used international inter-banking transaction on SWIFT



Foreign investors footprint on the mainland financial markets are more prevalent
Foreign investors on the mainland financial markets (share; total value)



Source: CEIC

Status: New, more targeted measures

- **CNY internationalization is still pursued but no longer an end unto itself.** After reappearing in the formal government plans in 2018, CNY internationalization made it into the 14th FYP. It now mostly shows as a secondary priority to broader targets (BRI in 2018 or trade stability in 2021).
- **Helped by an appreciating trend from mid-2020 to early 2022, the PRC has taken multiple actions to facilitate the use of the CNY abroad.** Local governments were allowed to issue CNY debt off-shore. Commodity markets in CNY have been deepened and opened further to foreign investors. Agreements were signed or expanded with some partners to spur the use of local currencies over the USD (Indonesia, Russia, Turkey, Sri Lanka, etc.).
- **Beijing has given up on capital account liberalization and opacified FX management.** Capital account liberalization has not reappeared in official plans. The counter-cyclical factor introduced in 2017 in the daily CNY fixing calculation formalizes the discretion of the PBoC on FX markets. The limited movement of FX reserves since 2019, despite strong pressure, signals that FX interventions have been delegated to some commercial banks.

Structural reform barriers

The CCP seems unwilling to accept less control on the value of the CNY or international flows. Greater CNY usage abroad means less control for Beijing - something leaders are reluctant to accept, as this would likely generate volatility, especially at first. Liberalization on outflows are largely opportunistic moves to fight appreciation.

CNY appreciation and a trade deficit, both needed for the CNY to challenge the USD, are off the cards for Beijing. For the CNY to be used as a store of wealth by foreigners, a sustained supply of CNY is needed, i.e. a current account deficit. Such holdings would push up the value of the CNY, hence be detrimental to the Chinese export industrial base,

The dominance of politics over economic matters within the CCP is a roadblock for the CNY to become a safe wealth-stock for international investors. The recent demonstration by the CCP leadership of its limited consideration for economic costs when it comes to top political priorities, adding to the uncertainty related to an opaque judicial system, limits the demand for CNY assets.

Positive and negative factors determine reform progress, or the lack thereof

The CCP's considerable resources and manpower allow for mass mobilization

Ex. Regional and individual income disparity – Xi's poverty alleviation campaign leveraged 3 million cadres to find citizens in extreme poverty and connect them with support

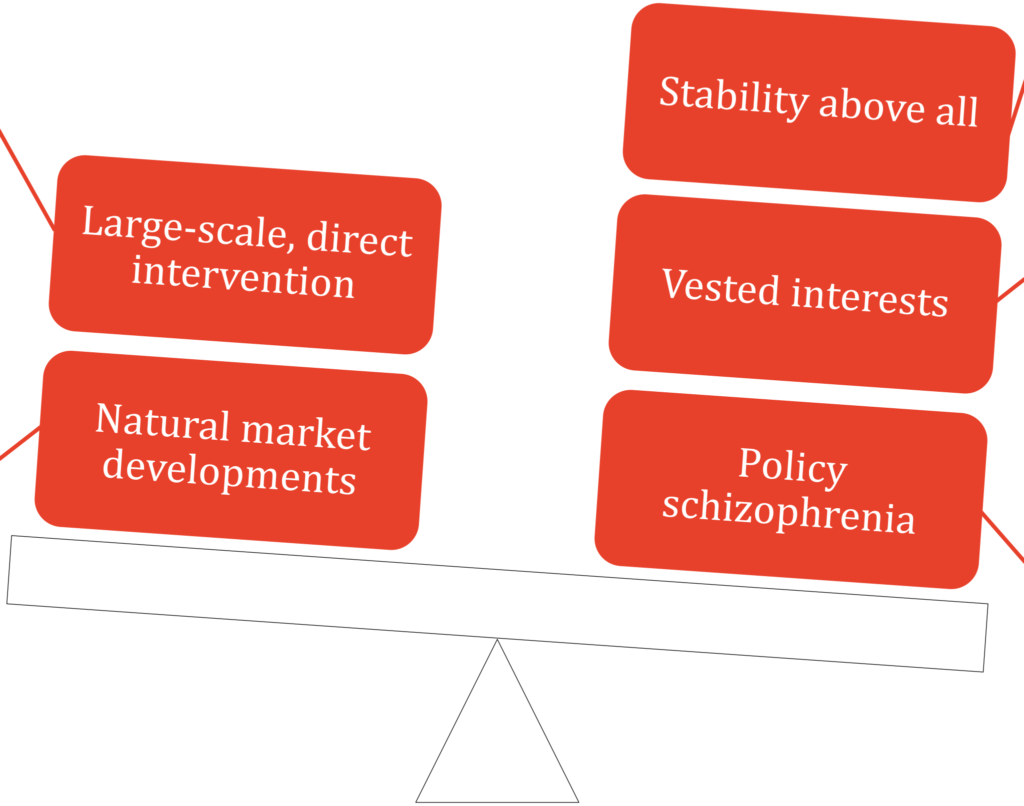
Trends that have little to do with policy, but which add to the stated goals of policymakers nonetheless

Ex. SME financing – The emergence of China's start-up culture, venture capital, and fintech created mechanisms to fill in the gaps left by the banks

Ex. Regional income disparity – The prosperity of richer coastal regions have led to lower-skilled jobs moving to less developed provinces, driving regional development

Drivers of success

Inhibitors of progress



The CCP's prioritization of economic and social stability inhibits reformers from taking necessary risks to see through major structural reforms that inherently destabilize things.

Ex. Capital account liberalization; Pension and hukou reforms

Areas of imbalance and inequality in China hurt some and benefit others, and those who benefit create hurdles for changing the unlevel playing field

Ex. SME support (SOEs oppose); pension reform and regional income inequality (the coast wants status quo)

Recent years have seen erratic prioritization from the top, often leaving officials unclear as to which objectives they should invest their limited time and resources into

Ex. Any and all reforms

Is this time different?

New factors that could drive reforms in Xi's third term

- **The Early Ming Emperor factor -** Xi is set to have power over the party-state apparatus unseen in decades. Considering his previous success in advancing major changes through the anti-corruption campaign and the progress on anti-poverty work, Xi may be able to overcome historic barriers to reform
- **Barbarians at the gates –** As external pressure from the US and allies grows, Xi may be able to galvanize the nation and advance major change, even if some have to ‚take one for the team' as support for innovative SMEs to close the tech gap could emerge, as could greater sacrifice from the well off under Common Prosperity

...and new inhibitors that could hold back meaningful change

- … **and the Late Ming Emperor factor –** However, centralized power and growing paranoia as problems pile up can lead to magnified impacts of bad decisions. Xi may well overreach, or he may not be recieving accurate information on the state of his reforms due to fear of delivering bad news to the core leader.
- **An ideological economy –** The pragmatism that drove the success of the first decades of the reform period is increasingly being subverted in favor of ideology, which could undermine structural reform… or even result in miscalculation in the face of pressure from the US and elsewhere.

On the whole?

- Xi will almost certainly have an easier time tackling vested interests in his third term which would be most applicable to issues like regional disparity and pension reform
- Yet, Xi has a mixed record on institution building, often preferring extralegal party campaigns in lieu of institutional state reforms – that could lead to band-aid solutions for all structural problems
- As internal pressure mounts under zero-covid and deleveraging and external pressure from an increasingly concerned west pushes him to invest even further in tech self-reliance, Xi likely lacks the resources for structural reforms and may instead kick them down the road yet again.