Exchanges at Goldman Sachs
China’s Congress: an inflection point?
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Allison Nathan: The 20th National Party Congress of the Chinese Communist Party that kicked off on Sunday promises to be one of the most significant events in China's modern history. That's largely because President Xi Jinping is widely expected to secure a third 5-year term as General Secretary, the top leader of the party, and a break from the long-held convention that Chinese leaders serve only two terms. And this unusual extension of Xi's leadership is coming amid the slowest pace of growth in the economic giant in decades. I'm Allison Nathan, and this is Exchanges at Goldman Sachs.

On this special episode, we're breaking down our most recent Top of Mind report. China's economy is facing
substantial challenges owing to the country’s ongoing zero COVID policy and significant stresses in its large property sector. Whether President Xi will use his further consolidation of power at the congress to shift policy priorities towards boosting growth is a critical question for China’s economic outlook. We first speak with UC San Diego's Susan Shirk for more context on the congress and its significance.
**Susan Shirk:** I'm sure I'm not the only person of a certain age who hears “20th Party Congress” and immediately thinks about destalinization, the secret speech that Khrushchev gave in the Soviet Union in which he criticized the over-concentration of power that Stalin had held and started destalinization in the Soviet Union. So that secret speech had tremendous reverberations for Communist countries around the world, but this 20th Party Congress will not be one of renouncing centralized leadership. It is really quite the opposite. It is confirming Xi Jinping's leadership and his intention to remain in power as long as he can.

So this is a major turning point for the Chinese political system because the effort, the dream of creating a resilient institutionalized Communist governance for China that Deng Xiaoping had ended.

**Allison Nathan:** It seemed at one point that Deng Xiaoping was on this track of reform of opening up, of collective leadership. Fast forward a couple of decades, and here we are staring at a very authoritarian, centralized government. What happened to move China so sharply in that direction over really a relatively short amount of time?
Susan Shirk: The Mao-like cult of personality, centralized, personalistic leadership is something that was established by Xi Jinping ten years ago. So that turning point was two Party Congresses ago, the 18th Party Congress. And what happened there was the collective leadership under Hu Jintao, Xi's predecessor, and Wen Jiabao. You had nine standing committee members, each of whom was responsible for their own set of bureaucracies and set of sectors, economic sectors, domains.

But my book *Overreach* actually dates the shift in the policies of China to be more aggressive internationally and more repressive domestically to the second term of Hu Jintao, not Xi Jinping. So you see, it depends what question we're asking here. If we're asking when did the over-concentration of authority that Deng Xiaoping had hoped to avoid, that's the start of the Xi Jinping era. But if you ask when Chinese policies became more problematic in a kind of counterintuitive way, it began under the Hu-Wen collective leadership.

Allison Nathan: We then asked Shirk what to watch for during the congress that could indicate a policy inflection
is coming. Her answer, the composition of the new politburo standing committee, the party's most powerful decision-making body, and how much Xi dominates it.

**Susan Shirk:** If Xi Jinping were to initiate a more moderate policy after the 20th Party Congress, it depends on who else is in the standing committee of the politburo. If coming out of the 20th Party Congress we see a little more balance between some pragmatic leaders with their own power bases, their own factions, in the standing committee to be something of a counterweight and to question Xi’s policies, if Wang Yang is premier, this is a leader with his own faction, with a strong reputation as being a reform-minded, open-minded guy, so I think that would be a good sign. And if Li Keqiang stays in the standing committee, that could lead to a little bit more power sharing than we have today.

**Allison Nathan:** But even if President Xi dominates the leadership decisions, as Shirk and the consensus widely expect, will China's economic challenges compel Xi to shift policy to reprioritize growth? Hui Shan, our chief China economist, doesn't think so.
Hui Shan: When it comes to cyclical policies that I don't necessarily think about the 20th Party Congress is likely a turning point. On zero COVID policy, we think it is really a medical question. Whether you have vaccinated your elderly, whether you can safely and orderly reopen, that's the key question. And by that standard, China is not ready to reopen, so we don't expect an immediate reopening after the 20th Party Congress. If you think of this as a medical consideration, then there are things you need to do. There are boxes you need to check before you reopen. So what are these things?

So number one, we need to see on-the-ground elderly vaccination rate increases. Number two, we need to see, in terms of a drug approval, treatment, development, there needs to be more progress on that front. And number three, if you think about people's perception, right now in mainland China, a lot of people are afraid of a virus because of the zero COVID policy and the government communications make it sound more severe than in other parts of the world. So you need to see the communication changes in such a way people won't be as afraid. And firstly, I think in terms of managing COVID, right now, every single positive case gets treated very seriously. They
either go to the hospital or go to the field hospital. We think the guidance needs to change. If you continue that guidance, then your entire healthcare system will be overwhelmed when you reopen. And we need to see signs of that that the guideline says you can stay home or quarantine without going to the hospital if you don't have symptoms.

On the property sector, what we have seen, it's very much data dependent. If the recovery is stalling or there's new negative shock, the government will step in and easing policy a bit further, whether it's cutting the mortgage rate or relaxing purchase restrictions. So that's regardless of the 20th Party Congress. But the big picture long-term structure policies, housing for living in, not for speculation, are unlikely to change.

The one thing I think that might change in the near term might be the policy coordination. Meaning, if before the Party Congress and the personnel reshuffling, the uncertainty about who is in charge or who might be taking over what portfolio is preventing officials taking on more initiatives and voter actions perhaps after the Party Congress, we can see more policy coordination and
initiatives that can be different.

**Allison Nathan:** More broadly, Shan expects China's leadership will increasingly embrace a new economic development model that prioritizes goals other than economic growth, so she thinks China's growth challenges could persist over the longer term.

**Hui Shan:** We think the big picture, long-term structure policies won't change that much the common prosperity to reduce income or wealth inequality. It's a housing for living and not for speculation. It's the environmental set of policies. It's the national security. Whether it's food supply, energy supply, semiconductor, technology, the self-reliance, all these longer term objectives are unlikely to change.

What are the implications for growth? These are objectives that make China's economic growth more sustainable or secure in some sense because you're removing inequality or excess leverage in the property sector or environmental degradation and so on. But the cost is a slower economic growth. In other words, the cost is less efficiency because you care about the quality rather than just efficiency. So
that's one of the reasons why, over the medium and longer term, we think the Chinese economic growth will be lower than previously experienced.

And the longer term declining birth rate and the slower population growth or even outright decline, that seems to be pretty difficult to reverse, looking at East Asian countries and looking at other countries of a similar developmental stage and going forward. So the economic implication is negative when you think about real GDP growth that involves labor, capital, and productivity. So your labor force, or your population decline, is going to become a headwind for economic growth. So that is one area that is contributing to our view that China is settling in a lower growth rate.

**Allison Nathan:** So what are we looking for in terms of growth this year, next year, and potentially beyond?

**Hui Shan:** So for this year, between the housing downturn, zero COVID policy, we are expecting only 3% GDP growth, and that's significantly below the government's targets set at the beginning of the year, around 5.5. For next year and in 2024, our forecast is
around 4.5% GDP growth, and that increase in growth rate is really coming from our assumption of China reopening, China exiting zero COVID policy.

But beyond that, if you look at our forecast for 2025, growth is going to be below 4%. That 3-4% range in the following years will be our baseline expectation and consistent with what we are seeing, that growth is on a slowed down trajectory.

**Allison Nathan:** But Tsinghua University's David Li believes the Party Congress will usher in a reprioritization of economic goals, given the rising risk that growth slowdown poses to the party and the country.

**David Li:** One of the most fundamental policy adjustments after the 20th Party Congress will be to put economic growth still at the center of the party's and the government's work. The current slowing down of the Chinese economy is mainly due to one factor, that is the COVID policy. And that policy for sure will be adjusted. I believe that the COVID policy will change not long after the 20th Party Congress, maybe at the end of this year, maybe in the spring of next year. Because without change in
COVID policy, other risks in economic development, in social management will mushroom into something big.

I have to explain the Party Congress in China is not only an occasion to change or make adjustments in the leadership but also an occasion for the rank and file to come together to talk about what's good in the past five years, what is not so desirable in the past five years, and what should be changed in the coming five years or even ten years. It's an exercise of looking back what has happened to our policy and what policy adjustments should be done down the road.

And this time around, in the 20th Party Congress, I believe that there will be an easing consensus. That is, the economy should be supported in order for the economy to continue its past path of reasonably fast pace of growth because, without this moderately fast pace of growth, our social problems or international problems, including, to be frank, the current tension with the US, cannot be mitigated, cannot be resolved, mitigating social problems, international tensions all boils down to one thing: Maintaining economic growth.
So I firmly believe that after the 20th Party Congress, a major and not fundamental -- and may not be high profile -- but very explicit shift to put economic growth at the center of the party's and the government's work. But how to do that? Simple. Number one, telling private entrepreneurs that you are part of our Socialist economy. You are part of our Common Prosperity agenda. We will not tax you. We will not regulate you ad hoc. Managing your business well is a good contribution to the whole society, to the country.

Number two, to taper off the campaign on Internet platforms. The Internet platforms have been under tremendous pressure of, I believe, overregulation. The campaign is now ending. Why is it ending? The answer is that the worry that the platforms are interfering in politics I think is dealt with. I think after this round of regulations, people all know that there's no worry. The leadership is so powerful. Who can rock the boat? No one can rock the boat.

And number three, policies to put economic growth as one of the major KPIs of local government as it used to be. Local government officials in China are appointed
according to KPIs. So in the past few years, KPIs have been social stability, pollution control, and lack of cases of COVID. But in the future, in the near future, it will be even more favored, tilted, towards GDP growth, tax revenue, employment, price stability, so on, so forth. So these are the few items of important and basic adjustments that will be coming.

**Allison Nathan:** Longer term, Li is not as concerned about China's demographic trends and broadly makes the case that China's economic miracle is set to extend. There's obviously a dramatic decline in birth rates in China, and some people expect the population to enter an outright decline from this year forward. So how big of a challenge to economic growth will these demographic headwinds be?

**David Li:** It's not a major problem. Why? Because let's ask ourselves what is one of the most fundamental forces of economic growth? Is it population, or is it human resources? Human resources, as a concept, is defined as the healthy population multiplied by the average level of education. The answer is, of course, it's human resources. That is, healthy population multiplied by education, which
is more relevant to long-term economic growth than pure population.

If you go by pure population, Africa has a huge young population. India has a huge population. And 50 years ago, China has a huge young population. Why didn't China grow fast 50 years ago? Why didn't Africa and many countries grow? The answer is the human resources. High-quality population. China's healthy population is still increasing. And Chinese education level is still increasing. Every year, we have 10 million college graduates. Roughly 50% of young people are studying in colleges. 40% of the 10 million have graduated from majors in engineering. And the Chinese economy still has very high savings rates. This economy is still full of people who are hungry for improving their daily living. They're working very hard. And this economy still is an economy which is catching up in many fronts with advanced market economies in the West. So the capacity in learning from the West, the capacity in emulating the technology success in the West is still there. So if you define China's economic miracle as being a sustained period of moderately fast pace of growth, then I would say that miracle will continue for another one or two decades.
Allison Nathan: Finally, with tensions between mainland China and much of the rest of the world running high, we also dig into whether the Party Congress could mark an inflection point in China's foreign policy. Here's Shirk again. What foreign policy areas are you most focused on where you think we might see the biggest shifts?

Susan Shirk: Well, the greatest risk is Taiwan. But what encourages some second thoughts and restraint, even though it is the focal point of Chinese nationalism, right, is the irredenta issue above all is that, to make some military move on Taiwan and fail, Xi has to worry that would be the end of him and even maybe the end of Communist Party rule because there's this widespread belief in China, whether or not it's true, that any leader who tries and fails and loses in a Taiwan contingency, people will rise up and replace him with some other form of government or at least another leader. And then of course we have the Ukraine example, which encourages greater prudence on the part of any Chinese leader.

But on the other hand, there's another widespread belief in China that Xi Jinping wants to resolve the Taiwan issue
and achieve reunification with Taiwan during his third term. And for many people, they think that's the justification of a third term.

**Allison Nathan:** And if we talk for a moment about the US-China relationship, where do you think it goes from here? And are there any key events that you're watching?

**Susan Shirk:** Well, I think what's critical is whether or not, after the midterm, the Biden administration makes a new push to attempt some diplomatic communication and negotiation with China. Because right now, the bipartisan consensus about the China threat, which in so many ways Xi Jinping has brought on himself by his overreach, is leading to a dangerously unbalanced approach with all sanctions, all pressure. Military deterrence I'm totally for. Help Taiwan. Work with Japan and other allies. Be prepared if things go south that we have those capabilities in the Asia Pacific. The Quad, AUKUS, all of that.

But where's the diplomatic engagement with China? We haven't had any real diplomacy for six years, and I personally am genuinely agnostic about whether or not it is possible for us to influence Xi Jinping in the direction of
moderating his policies and ending some of the more aggressive actions through not just retaliation of sanctions but through negotiation. And I believe we haven't actually tested it. So what I would hope to see is a return to some good old-fashioned diplomacy between the United States and China after the midterm and after the 20th Party Congress, again, as a test in which we will get more information then about the character of the Xi regime and whether or not it's possible to induce any adjustments in their policy.

There are things you'll never get anywhere on, but I think even in some South China Sea-related things, in the economic policy, I think we could negotiate some modifications. And of course a lot depends on whether or not the presidents can meet face to face. Joe Biden has more experience with the current leader of China than any previous US president has. When they were vice-presidents, they spent a lot of time in an exchange of visits, so there's a foundation to build on.

The challenge for American diplomacy and for the diplomacy from other countries -- Japan and Europe as well -- is to help Xi Jinping say that they are still open to
having a China that is a responsible global power and that Xi has a path that he could take of being more restrained in his foreign policy and achieve respect, influence in that way.

**Allison Nathan:** But are you not giving too much credit, though, to the US side of this? Do you think that the US really does want a very powerful China at this point?

**Susan Shirk:** No, I think right now public opinion and political opinion, not just in the United States but in Europe and Japan and elsewhere, have turned sharply negative toward China. But there is another path. And I think that Xi is overreaching, and the United States is overreacting in the sense that we are embracing policies, taking an approach which is actually going to harm our own competitiveness, our own market economy. It's going to lose us the talent from China and around the world, which is a great asymmetric advantage of the United States, that people want to come to our universities and stay here. I believe that our approach is going to be harmful to ourselves. And I'm hopeful that we might start to see a little bit more of a debate about the costs and benefits of our policies.
**Allison Nathan:** With questions about if and how China's policies will evolve after the Party Congress sure to remain in focus, we'll continue to keep a close eye on how the congress and China's economic policies unfold from here. I'll leave it there for now.

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