EURICS.
欧洲中国研究院 European Institute for Chinese Studies

n° 3
May 15th, 2020

Briefs | Analyses

What does the COVID-19 crisis tell us about China?

Towards a rebalancing between growth and equity? Chinese academic social networks on the pandemic

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[EURICS fellow, spring 2020]

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AN OPPORTUNITY FOR A NEW DEVELOPMENT MODEL IN CHINA?

"National governments can pump [money] into the economy as much as they need." These words are those of Ursula von der Leyen, President of the European Commission, announcing on 20 March 2020 the suspension of European budgetary rules. A few months ago, one would only have imagined a radical politician or economist considering such a response. But as French President Emmanuel Macron recently pointed out in an interview with the Financial Times, with the COVID-19 crisis, "We all face the profound need to invent something new, because that is all we can do (…) We are all embarking on the unthinkable."

The rescue measures initiated by the major Western governments in response to the COVID-19 are indeed all quite "unthinkable" in normal times. France's rescue package amounts to 110 billion euros so far and the budget deficit forecasts to hit 9% of gross domestic product (GDP) for 2020, well above the limit usually allowed by the European "golden rule" that requires the public deficit to remain below 3% of GDP. Germany's rescue package stands at 356 billion euros and amounts to 10% of its annual GDP, and some bailout funds can be used to recapitalise troubled private enterprises and so could pave the way for partial nationalisation. In the United Kingdom, the State has offered to pay up to 80% of employees' wages in order to prevent companies from laying off their workers. The US are providing $1,200 to everyone earning less than $75,000 a year and its *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) passed on March 27, 2020, is a 2 trillion dollars rescue and investment plan. No wonder, Willem Buiter, the former chief economist of Citigroup, named these radical measures as "Pandemic Socialism."

Pandemic Socialism?

China was the first country to be affected by the coronavirus, though no major rescue package has yet been announced there. Curiously, China's economic measures have been quite modest so far compared to those adopted in Western countries. This is particularly surprising given China's response to the global financial crisis of 2008. At that time, China set up a huge stimulus package:

With its 2008 fiscal stimulus package, China has built a railway network, thousands of hospitals, and has highly improved health coverage, but investment of banks and local governments in bad projects also generated a huge domestic private debt.

a 4 trillion yuan public spending programme ($586 billion), amounts to 12.5% of its GDP that year. According to Adam Tooze, History Professor at Columbia University, "It was the first truly large-scale fiscal response to the crisis worldwide."

The reason for this Chinese global lead in fiscal stimulus was that fiscal policy in most Western countries had been crippled by "balanced budget rules" (for instance in the US) or the "3% rule" (as the case of the EU). For these countries, monetary policy had become the "only game in town." But after the European Central Bank lowered the nominal interest rate to negative (-0.4%) in 2014, there were no further room for monetary stimulus either. Indeed, once a nominal interest rate reaches a negative level approaching -2%, people prefer to put their money under their mattress, so they can at least get an interest rate of zero. This is what economists call the "zero lower bound" dilemma: nominal interest rates cannot go too far into negative or it will cause a liquidity trap. Arguably, the constraints of fiscal and monetary policy explain the slow recovery of Western countries' economies in the aftermath of the 2008 global financial crisis. But COVID-19 seems to have awakened Western countries: fiscal policy is regaining its key role, in coordination with monetary policy, in the fight against economic recession.

Why has China not yet repeated the 2008-style fiscal stimulus package?

In order to answer this question, we need to understand two successes and one failure of the Chinese 2008 fiscal stimulus programme. The first big success was the construction of a high-speed railway network between 2008 and 2014 which reduced the journey from Beijing to Shanghai to 4.5 hours. By importing the most advanced technologies from Germany and Japan and combining them with local innovations, China has developed one of the most efficient rail networks in the world. The second big success was the huge public health investment. Two thousand county hospitals and five thousand township clinic centres were built with the fiscal stimulus money, and **health insurance coverage was extended from 30 percent to 90 percent of the Chinese population.** It meant a huge progress in covering rural people.

However, not all infrastructure projects have been so successful. In a rush to match the central government's fiscal stimulus program, many banks and local governments imprudently invested in too many bad projects. As a result, the Chinese economy has built up excessive productive capacities and enormous domestic private debts (mainly debts of private or public companies—owned by the state or local governments). Between 2008 and 2016, the domestic private debt to GDP ratio has roughly increased 100 percentage points, from 140% to 240%. This explains why the Central Government is reluctant to have another 2008 style fiscal stimulus now: it may worsen the bad debt problem and possibly lead to a domestic financial crisis.

Of course, this does not mean the Chinese central government has done nothing to mitigate the adverse economic consequence of COVID-19, only that the measures taken so far are relatively modest. For example, since February, relevant ministries of the Chinese Central Government have announced temporary policies such as exempting VAT for small businesses, exempting or halving social insurance contributions by employees, and encouraging local governments to waive urban land-use taxes in order to reduce rents facing companies. The Central Government also required utility companies to lower the price of electricity in order to cut the cost of resuming production. On March 13, the Chinese Central Bank also cut reserve ratio by 1% thereby releasing 550 billion yuan ($80 billon) of long-term funds.

A new policy: "six protections"

While no public investment programme comparable to that of 2008 has yet been announced, there are increasing signs that China's modest economic policy response to COVID-19 is going to change. On April 17, the Politburo of the Chinese Communist Party held a meeting in which a new policy of "six protections" has been announced. In fighting against the adverse economic consequences of COVID-19, the Politburo said, **the first priority is to protect people's employment. The five other protections are protecting people's basic livelihood, protecting market entities (avoiding too much bankruptcies), protecting food and energy security, protecting the supply chain of industries and protecting the functioning of the local society.** The same day, the Chinese State Statistical Bureau published the data of the 2020 first quarter GDP growth rate—negative 6.8%. It is the first time the growth rate turns negative in China since 1976. It is no coincidence that the announcement of the new "six protections" policy and the announcement of the National Bureau of Statistics took place on the same day.

On April 20, the State Statistical Bureau published another set of data. The important thing to notice is that urban employment declined by 6% in China in the first quarter of 2020. In 2019, the Chinese urban employment population was 440 million, so the 6% decline means 26.4 million people exited from the labour market due to COVID-19. These are mostly rural migrant workers who returned to the countryside since they could not work in the cities during the pandemic. Technically, they are not counted as "unemployed," but obviously they should be a main concern for achieving the "first protection" (namely, protecting employment) goal of the Politburo. In the same meeting on April 17, the Politburo also decided to issue a "special public debt for fighting COVID-19". This leads to some interesting debates among Chinese economists on whether the rule that the budget deficit should not exceed 3% of GDP should be abandoned this year in China.

The European "golden rule" applied in China

It may be a surprise to some European readers to know that China also implicitly adopted the 3% "golden rule" since 1998. Since the economic reform in 1979, the government has been very cautious about its fiscal policy. Prior to 1998, China's budget deficit-to-GDP ratio was maintained at a relatively low level, below 1% on average. China started to implement an expansionary fiscal policy in 1998 to counter the economic slowdown caused by the Asian Financial Crisis. In 2001, the Chinese Central Government's fiscal deficit was 260 billion yuan, or 2.7% of its GDP of 9,593 billion yuan. The following year, the budget deficit was forecast at 309.8 billion yuan, with a target growth rate of 7%. Thus, the budget deficit would work out to be 3% of GDP in 2002. However, at the National People's Congress, some elected delegates questioned the viability of such proactive fiscal policy, even calling Zhu Rongji a "deficit Premier." Zhu rejected the criticism and held that China's budget deficit-to-GDP ratio of 3% was within the internationally acknowledged "safety limit." Zhu emphasised that his deficit went into long-term capital investment, such as roads, ports, and other infrastructure, so it was consistent with the EU's 3% rule which allows borrowing for public investment in the "capital account," but did not permit borrowing for consumption in the "current operational account" of the budget.

China's adherence to Europe's golden rule that the budget deficit should not exceed 3% of GDP probably dates back to this episode. Since then, China has followed it without interruption, even in 2008, when the global financial crisis hit China hard. The golden rule has not prevented China from launching a huge fiscal stimulus programme, as China's budget deficit was only 0.3% of GDP in 2008, and its rise to 2.7% in 2009 was sufficient to support a big fiscal stimulus. Because of the coronavirus pandemic, this year may be different. Yu Yongding, an influential economist who once served as a member of the Monetary Policy Committee of the Chinese Central Bank, argued that in 2020 the budget deficit/GDP ratio needs to reach 5%. Some other economists disagreed. They still think the 3% "golden rule" reflects the "international norm."

My view in this regard is that we should understand why 3% was chosen and written into the Article 126 in the EU's Maastricht Treaty in 1992. This so-called golden rule of public finance is based on the idea that borrowing is allowed for capital investment expenditures only, while the current operational account must be balanced. Three percent was chosen in the EU because the historical average of public investment expenditure to GDP in the European Community was that ratio. **If China wants to follow the EU's 3% rule as an "international norm," it should follow the spirit of the rule rather than adopting literally 3% as the deficit ceiling.** The ratio of China's public investment expenditure (both budgetary and extra-budgetary) to GDP averaged at least 4.5% on historical average. Therefore, the application of the "golden rule" to China would give, conservatively, 4.5% as the deficit ceiling, not 3%.

The People's Congress session on 22 May 2020: a turning point?

We will soon know what will happen with the Chinese budget, since the annual session of the People's Congress will open on May 22nd in Beijing. It will be interesting to see whether a major 2008 style fiscal stimulus package will finally be announced. If so, how will China resolve the bad debt problem? I hope that this time, the stimulus package will devote more resources to social welfare spending and that investments will be made in public projects similar to hospitals in 2008. This way, China would avoid repeating the pitfalls of the previous plan. It would also allow China to start building a more socially inclusive development model.

Will my hope be borne out in the May 22 session of the People's Congress? My confidence is not very high. Though China officially claims to be a "socialist" country, the share of social spending in its GDP has not been very high since the start of economic reform in 1978 (compared to advanced Western countries but also to some developing countries). Before the 2008 global financial crisis, the Chinese official policy slogan was to "give priority to efficiency while taking into account equality." The construction of public hospitals and increased health insurance coverage for the rural population as part of the 2008 fiscal stimulus package was a big improvement. However, **the old way of thinking about development which gives priority to "efficiency" considerations (such as rapid GDP growth) still has a strong hold.** For instance, this can be seen in some measures to alleviate the economic hardship caused by COVID-19 in Wuhan, where the epidemic began. Instead of giving cash directly to people, as the US CARES Act does, Wuhan Municipal Government has only distributed a modest amount of "consumption coupons" that can be used in selected stores to residents.

Hopefully, the severe economic slowdown in the first quarter of 2020 will be a wake-up call. As Nobel Prize economist Paul Krugman put it, in times of pandemic crisis, we need "disaster relief with a dash of stimulus." In other words, the fight against COVID-19 shows the relationship between efficiency and equality is not a "tradeoff," but rather "complementary": more social spending and more equality will lead to more efficiency. This could finally lead to a new development model, based on the mutual reinforcement of efficiency and equality concerns. There is much at stake for China and the world in what will be announced on May 22 session of the People's Congress.

This article has been co-written with journalist* **Aurélie Louchart

To go further

Read **Zhiyuan Cui**'s article in French and English and turn to additional references on **eurics.eu**

Xiao Lin

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PhD in Linguistics of Sorbonne Université, her first book has been published in 2019 by the Société Linguistique de Paris (Peeters Publishers, Leuven). She obtained in 2020 the Jean Perrot Prize of the Académie des Inscriptions et des Belles Lettres and the "Young Researcher Prize" by the prestigious Fondation des Treilles.

The COVID-19 pandemic has led to a reprogramming of EURICS activities. We keep watch on Chinese social networks regarding users' thoughts and comments on the coronavirus that were not reported in the Western media. Three brief notes have been written up to now and are available upon request.

Controls in China regarding the publications on the pandemic

At the beginning of April, a significant number of messages on the websites of several universities criticised the decision of the Central Government to control, silence and censor any publication of academic type relating to the origin of the coronavirus on the Chinese territory. These posts have been removed from the websites or have been cut off. Henceforth, and this is new, control is exercised first at the local level by the academic committees of the universities, which assess the conformity with the official position. They are then sent to the Ministry of Science and Technology which gives—or not—the green light for the articles to be published, including when they are submitted to international journals. Why these new controls? According to some posts, the government would like to deny that the coronavirus was transmitted to humans by animals at the Wuhan fish market.

Note on the mutation capabilities of the COVID-19

Several messages from academics note that the mutation capabilities of COVID-19 have been underestimated and are slowing down the possibility of having a vaccine in a fairly decent timeframe. These posts refer to the outcomes of a scientific study conducted by the team of Professor Li Lanjuan of the University of Zhejiang, which has not yet been validated internationally for publication. This research reports a mutation in about thirty different strains. Several of them are said to have much higher viral loads than the original viral load. The virus that is currently circulating in Italy, Spain, Belgium, France and the United Kingdom could be a version which has mutated and which is more severe than the virus of Chinese origin that has caused a much lower death toll.

Mention of coronavirus in Ancient China

Linguists discussed an article by Liu Zhao on epidemics (and coronavirus) in Ancient China. We find mentions of coronaviruses from the pre-archaic period (13^{th} - 11^{th} centuries BCE) on oracle bones inscriptions. The Chinese character for the name "epidemic" used in Archaic Chinese is written with the 'water' radical, because coronaviruses were associated with that element. To get rid of the virus, you should throw it into the water. This was the best way to see it disappear: *ding sha* 'kill in the water'. One can also "bury it alive" (*sheng mai*) and one needs to be under "quarantine" (*qian li qian suo*). In the bamboo strips extracted from the archaeological site of Shuihudi (Hubei province, home of the epidemics today) and which date from the 3^{rd} century BCE, the epidemics were associated with evil geniuses. “In a house, when an epidemic occurs for no reason, it reaches everyone; some die, others are seriously ill. The evil genius is there, he is ambushed (somewhere)... You have to dig it up and throw it away, and the epidemic will end.”

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