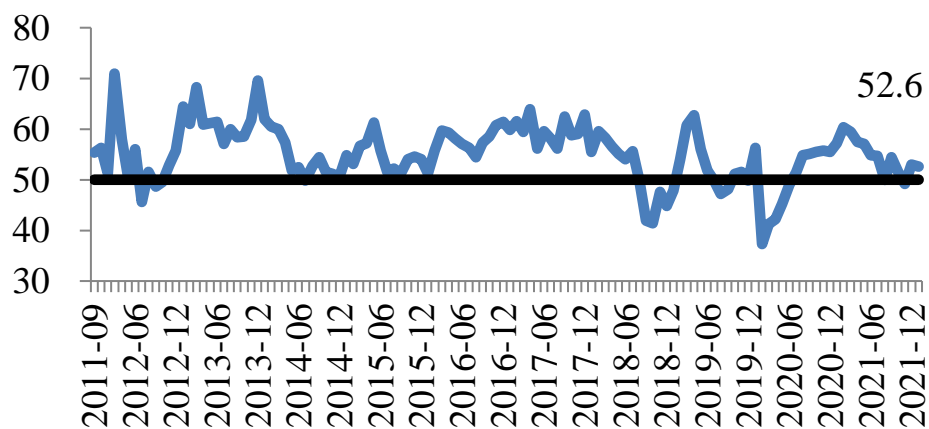


## Commentary on the January 2022 CKGSB Business Conditions Index

*Professor Li Wei*

In the first month of 2022, the CKGSB Business Conditions Index (BCI) dropped a little, from 53.1 to 52.6, but remained above the confidence line of 50.0 (Figure 1). According to our sample comprising of successful business owners in China, company prospects remain positive for the next six months.

**Figure 1 Business Conditions Index (BCI)**



Source: CKGSB Case Center and Center for Economic Research

The biggest macroeconomic news this month is the release of GDP statistics for 2021. GDP growth rate for 2021 as a whole reached 8.1% year-on-year, which is more than the government's goal of 6% and close to market expectations. However, the data from the first to fourth quarters showed rapidly diminishing growth, falling from 18.3%, to 7.9%, 4.9% and 4.0%. While the context for this is a massive contraction in the first quarter of 2020, it does show that the growth rate itself is in decline. Now, the government and the market agree that the economy needs until the second half of 2022 to strengthen and stabilize. For this reason, calls for stimulus are becoming shriller.

Stimulating economic growth in times of economic downturn is a necessary, but not sufficient, move. I believe that there is one more important thing that can and should be done, and it's no less important than stimulating economic growth: innovating. The significance of innovation itself can hardly be overstated. Without it, there will be no lasting high-quality growth. Without it, China's bright economic future is in jeopardy.

Giving an example, where did reform and opening up come from? We know that when the Third Plenary Session of the Eleventh Central Committee was held in 1978, the Party and society immediately shifted the focus of work to economic construction. But how to carry out economic construction was a mystery at the time. There were no students of modern economics to call on. There were obviously problems with the things they learned from the Soviet Union in the past, and they knew they would have to think afresh, but what to do? The prevailing view was the "two

whatevers” (we resolutely uphold whatever Chairman Mao says; we unswervingly follow whatever Chairman Mao orders). But the “two whatevers” would lead back to the rut of the planned economy, and it would be impossible to extricate the country. Hu Yaobang and others first put forward the notion that “practice is the only criterion for testing the truth”, which opened the door for innovation. In this environment, Nian Guangjiu, “the stupid melon seed dealer” was not looked down immediately as a “tail of capitalism”. Shenzhen and other special economic zones introduced foreign capital and joined the international division of labor. With development, the household contract responsibility system in rural areas turned into a mainstream production system.

These economic development policies have traces in the past, but due to the general environment at that time, especially the shackles of people’s minds, these policies could not be implemented. When these shackles were broken, positive policies had room to flourish.

To give another example, in 1989, there was serious political turmoil in China, which led to a sharp decline in economic growth. At that time, the idea of being identified as either “capitalist” or “socialist” was the talk of the nation, and people's enthusiasm for economic development was at its height. In 1992, Deng Xiaoping delivered a speech on his “Southern Tour” and put forward the “three favorables” criteria (judging whether something is good mainly depend on whether it is conducive to the development of the productive forces of a socialist society and whether it is conducive to the enhancement of socialism. Whether the country’s comprehensive national strength is conducive to improving people’s living standards). All of a sudden, the problem of whether something is capitalist or socialist became an issue of economic development, which liberated people’s minds. Policy innovation, social innovation and business model innovation flourished for a while.

China’s GDP growth rate in 2022 is expected to be around 5%, but this is a conclusion based on certain assumptions, including that China’s policy environment has not changed significantly, and the international environment facing China’s economy has not significantly changed. The coronavirus will inevitably continue to have an impact on the economy. Ever since reform and opening up started, it appears that when economic growth slows down significantly, large-scale structural reforms have the opportunity to substantially change China’s policy environment, activate economic potential, and enhance potential growth. The implementation of structural reforms is often a case of policy innovation. China's economy now has made great progress in the past 40 years, but our per capita GDP has just crossed 10,000 US dollars not long ago, which leaves a huge gap with the 40,000 to 50,000 US dollars common in developed countries. According to China’s Bureau of Statistics, 600 million residents have a monthly income of only 1,000 yuan. China still has a long way to go to become a developed country.

The large gap between China and developed countries also means that China still has a lot of room for development. As long as we actively and steadily promote structural reforms and exploit the potential economic growth rate to the full, then we can usher in a new round of growth, indeed high-quality growth, and innovation can take its rightful place in the arsenal pushing structural reform.

However, we should point out that structural reform may be beneficial to economic growth in the long run, and also detrimental to economic growth in the short term. Compulsory education reform, reducing students' heavy homework burden and afterschool training burden is indeed beneficial to economic growth in the long run, but it is detrimental to the tutorial industry and growth in the short term. From this point of view, when we carry out structural reform, we can introduce measures that are beneficial to economic growth and measures that are not conducive to short-term economic growth, so as to balance the influence of both sides and avoid excessive negative impact on the economy.

Finally, there is another point that needs to be pointed out, and that is the impact of inflation abroad on China. The US CPI in December 2021 reached 7%, and the Federal Reserve is expected to accelerate its tightening monetary policy as a result. U.S. interest rate hikes will increase the attractiveness of dollar assets, and in this case, dollar appreciation is a high-probability event. Chinese companies including Evergrande Group have borrowed a lot of US dollar bonds on overseas capital markets. The rise and appreciation of the US dollar will inevitably increase the debt burden of these companies, weakening their already fragile balance sheets. In this sense, China does need a certain degree of macro-easing policy to deal with the current situation. Of course, this does not mean that we need to reduce the intensity of structural reform. This is the foundation of growth and cannot be ignored. However, right now, combining a certain degree of macroeconomic easing policy with structural reform is the best way forward.

This is a commentary on the CKGSB BCI report for January 2022 to which you are welcome to refer for detailed statistics. Do not hesitate to contact the BCI team by email for the accompanying BCI data report.

CKGSB Professor Li Wei

28 January 2022