How to Assess the Economic Situation in the Anti-Epidemic Growth Model[1]

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Abstract: The coronavirus outbreak has been escalating overseas, and the global curve is moving up with no inflection point in sight. The duration of the second wave of its impact will be much longer than the first wave, accordingly the entailed growth shrinkage will probably surpass the first wave. We will have to face and adapt to the reality, which is that the economy is shifting from the conventional growth model to an "anti-epidemic growth model" and stick to it for a long period of time. Under this model, the relative growth rate may be a more appropriate measure of China's economic performance, and the top priority would be to ensure stable consumption, provide enough direct subsidies and save enough capital for foreign trade enterprises facing the second wave of shock.

I. The second wave of shock should not be underestimated; relative growth rate is more suitable for evaluating growth as the economy shifts to the anti-epidemic growth model

China was the first to be hit by the coronavirus outbreak at the beginning of the year. For more than a month, its economy was put on a pause. At present, our economy is on

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the road of recovery. However, the outbreak has been escalating overseas, and the overall curve is moving up with no inflection point in sight.

According to the latest WTO estimate, the pandemic will inevitably deal a severe blow to the global economy in 2020, the global GDP may decline by 2.5%-8.8%, exports may drop by 17.1%-40.9%, and imports is expected to fall by 14.5%-33.8%.

China's exports and imports in the first quarter respectively went down by 11.4% and 0.7% year-on-year. After the second quarter, outbreaks overseas are projected to further weigh on China's exports and imports, which will bring a second wave of shock on its economy. Some study predicts that the imports and exports of China in 2020 may witness a decline of 15%-20%, with a larger decline in trade in services.

Some believe that considering the relatively low share of net exports in GDP, it would only have limited influence on domestic growth unless it suffers a substantial decline. The view makes sense in a normal growth scenario. Excessive decline in exports in a short time, however, may result in massive shutdowns of export-oriented enterprises, directly hitting domestic consumption, investment and employment. It could be seen from the input-output analysis that one-percentage-point drop in exports would shrink the GDP by about 0.2 percentage points. The latest information indicates that orders received by foreign trade enterprises have already started to plummet.

The impact of the 2008 global financial crisis on the Chinese economy also backed up this view. During the financial crisis, the 30-percentage-point decline from the peak in exports caused the GDP to fall by 7 percentage points.

The mitigation of the second wave of shock hinges on the global evolvement of the COVID-19 pandemic, which faces three major uncertainties. Firstly, United States, Japan and European countries may embrace their inflection points after a while, but it would be difficult for them to reduce new infections to zero like China did within a short period of time under their current control measures. As a result, there will be quite a long tail. Secondly, epidemics in developing countries such as India and African countries have yet to enter a stage of exponential growth. Thirdly, whether the pandemic will persist all year or even for a very long time remains unknown.

In this context, the duration of the second wave of impact will be much longer than the first wave, the entailed growth shrinkage will probably surpass the first wave as well.

I agree with the view that the end of the global outbreak does not rest with the country ending the epidemic first, but the country with the poorest performance in epidemic control, because we are on an interconnected earth.

Therefore, **we will have to face and adapt to the reality that the economy is shifting from the conventional growth model to the "anti-epidemic growth model" and stick to it for a long period of time**. One major feature of the latter is that we need to pay the "anti-epidemic cost", which means it is always necessary to devote some resources to preventing the import of cases and the domestic recurrence of outbreaks, hence it will be impossible to achieve the potential growth rates.

In this case, the context for growth in 2020 will go through significant changes. China's GDP is estimated to contract by 5% in Q1 and rebound to positive growth in Q2. Assume the growth, buttressed by economic rebound and stimulus, can surpass the potential rate by 2 percentage points to reach 8% in Q3-4 when disregarding the second wave of shock, it would be a great feat if we can achieve a 3% growth for the whole year as the second wave of shock, when taken into consideration, will cut 2-3 percentage points off the rate in Q3-4. Against a deep economic downturn worldwide, the 3% growth rate would be a hard-earned victory. **It could be said that the quality of the 3% growth rate under the "anti-epidemic growth model" is far beyond that of the 6% growth rate under the conventional growth model.**

Corresponding adjustments should also be made to the assessment on the growth target. I recommend to adopt the “relative growth rate”, which evaluates China’s economic growth through the difference between China’s growth rate and the global average. The basic background of this approach is that China’s economy has become well integrated with the global economy and the pandemic has a tremendous influence on the entire world. A stable or larger difference compared with the past indicates a favorable performance of China’s economy. Otherwise, it signifies poor economic performance in China. For example, the global economy grew by 2.9% on average in 2019, while China’s economy expanded by 6.1%, so the relative growth rate was 3.2%. If the world economy shrinks by 2.5% and China’s economy grows by 3% in 2020, the relative growth rate would be 5.5%, which outperforms that of last year.

One advantage of this assessment approach is that we do not need to be restricted by the previously-set growth target, which in particular would allow us to avoid achieving the target set in the conventional growth model with excessive stimulus. Instead, we could develop and realize a more scientific and practical growth target suited for the anti-epidemic growth model.

II. The top priority in maintaining steady growth is to ensure stable consumption. Direct subsidies should not be provided in small doses. In the meantime, we need to save enough capital for foreign trade enterprises facing the second wave of shock.

Short-term policy design should match the present economic shock. The slump this time is caused by an unexpected mega external shock, rather than an endogenous shock caused by serious shortage in demands, excessive leverage, etc. That is the fundamental difference between the current economic crisis and previous financial or economic crises.

Economic recovery depends on two factors, duration of the pandemic and damage to the production capacity. The economy may rebound in a v-shaped recovery in the post-epidemic period, if the outbreak does not last long and the production capacity suffers only limited damage; otherwise the economic recovery will not be so easy. In addition to bringing the epidemic under control as soon as possible, priority of short-term policies should be also assigned to protecting production and mitigating relevant damage .

Short-term policies should focus on "recovery", "relief" and "risk avoidance". Recovery means reconnecting interrupted supplies and demands. Restoring demands, instead of expanding demands as some suggest, is the top priority at the moment. Relief aims to support struggling enterprises and individuals who may not survive the current crisis, with the emphasis on micro, small and medium-sized enterprises and low-income populations. Risk avoidance is to prevent and control the potential risks arising from existing structural issues in the economy, focusing on guarding against shutdowns or chaos in the financial system triggered by tightened liquidity.

From this perspective, **the point of fiscal policy is to offer relief.** The government has decided to issue special national bonds, the money raised from which will go mainly into the relief package. Meanwhile, t**he focus of monetary policy lies in risk avoidance.** We should recognize that the Fed reacted quickly this time to stabilize market expectation with sufficient liquidity, thereby preventing the chaos or even collapse of the financial system, albeit with a huge price.

The People's Bank of China adopted proactive and effective policies at the same time. The financial data in March demonstrated the significant increase in social financing. Massive liquidity injection is the only option to ensure the continued operation of the economy when the real sector hits the brake and almost comes to a full stop. However, China's economy and developed economies are at different stages of development.

China still has a huge growth potential, hence stimulating the economy in China mainly relies on structural momentum rather than macro policies. Therefore, **China should be capable of maintaining normal monetary policy without following suit with negative interest rates.**

The following three issues in short-term policies deserve our attention.

First, **the top priority in maintaining steady growth is to stabilize consumption.** During previous economic downturns, our first thought would be to ramp up investments, particularly in infrastructure, which had much to do with the growth stage we were in and the economic structure of the day. To cope with the global financial crisis in 2008, we launched the 4 trillion stimulus package. Of the expenditure-based GDP increment in 2008, investment and consumption accounted for 62.8% and 42.5% respectively. The former declined to 17.2% in 2019, and the latter increased to 66.9%, of which household spending accounted for 49.5%. These data demonstrate that the top priority in maintaining steady growth is to ensure steady consumption, especially in the household sector. We won't be able to stabilize the economy if we fail to stabilize the main source of growth and instead rely on the much smaller end—investments, especially infrastructure investments.

Second, send direct subsidies to low-income population. The topic derives from ensuring steady consumption. Whether to distribute cash or issue coupons without too many strings attached is still up for discussion. The common practice in developed countries is to offer monetary subsidies, which means sending money directly to residents' bank accounts. In China, the basic infrastructure for identifying and subsidizing low-income population have not been completely established, which is our weakness. Nevertheless, considering the current digital technologies, speeding up the foregoing "new infrastructure" should not be a great challenge. In addition, the current need also put forward an opportunity for shoring up this weak spot. For the time being, we may take advantage of available channels, acquiring information of low-income population from poverty-stricken regions, urban social security system and individual income tax declaration system, etc. It should be noted that **we need to ensure the subsidies indeed reach the low-income population; encourage people to spend the subsidies as much as possible; and set the amount of subsidies at an appropriate level, e.g. equaling one-month income or expense of the low-income population.**

Meanwhile, a related issue also requires discussion. Direct subsidies to low-income population should not be deemed as encouraging laziness with welfare. On the one hand, subsidies are conducive to stabilizing consumption and growth, as part of the subsidies will convert into enterprise revenue and government fiscal revenue; on the other hand, subsidies to low-income population would contribute to narrowing income gap, powering productivity and improving human resources, since the low-income population are not only consumers but also producers with the largest room for human resource improvement.

Third, we should save enough capital for foreign trade enterprises facing the second wave of shock. Financial aids shall be distributed among enterprises in a balanced manner. The second wave of shock has just started, no one could yet accurately predict its peak or tail. **Export-oriented enterprises are the most dynamic and competitive sector in the Chinese economy, their collapse will cause inestimable loss to the economy of China. Therefore, the majority of funds in the relief package should be allocated to them.**

Direct subsidies to low-income population may also be combined with financial aids to foreign trade enterprises. The government could provide a certain amount of subsidies to staffs below a certain income level in struggling foreign trade enterprises, to help enterprises to maintain their workforce. This way, the subsidies may increase consumption spending, reduce cost and stabilize employment simultaneously to maximize policy outcomes.

III. Substantially deepening reform is the best stimulus policy. We should promote the development of metropolitan areas through factor market reforms, and turn it into a new "driving force" for China's economic growth.

A large gap in GDP growth will remains even with a speedy economic recovery. Besides, the aforementioned "anti-epidemic cost" also needs to be set off by new demands. How to cultivate new growth momentum is a problem to be solved by the medium- to long-term policies which should match the short-term policies.

In the next five to ten years, the accelerated development of metropolitan areas and city clusters will become the greatest structural potential for the economic growth in China. In other words, it is a new driver of China's economic growth.

The so-called metropolitan areas, in a geographic sense, is a new urban network system that interconnects emerging small towns or small cities located within one-hour commute or within 50 to 70 kilometers (the figure may vary depending on local geographic conditions) of core cities.

In general, the key to developing metropolitan areas lies in the "area", which is to boost the transformation and upgrading of metropolises and megacities through tackling the structural contradictions of the core cities and extending urbanization space. Specifically, the development of metropolitan areas is beneficial for the adjustment of industrial structure, especially the manufacturing industry; beneficial for the adjustment of population structure, during which significant improvements would be made on living conditions and quality of life; beneficial for improving jobs-housing balance, and reducing traffic congestion, air pollution and commuting pressure; beneficial for the improvement on living conditions of rural migrant workers in cities and other migrant population, as well as their access to basic public services; and beneficial for promoting green and innovation-driven development, and facilitating the transformation toward a high-quality, sustainable and resilient development model.

From the perspective of growth drivers, small towns and cities need the construction and renovation of massive residential houses and public facilities, rail transport networks need to be built to connect different towns and cities, and small towns and cities with industry clusters call for new industry investments as well, all of which could drive consumption and investment at the same time. **Based on a preliminary estimate, the construction of metropolitan areas could contribute 0.5 to 1 percentage point to the national economic growth each year for the next 10 years. In addition to its role in offsetting the pandemic shock, the development of metropolitan areas will also provide strong support for the medium-speed and high-quality economic growth in the long run.**

The recently hyped concept of "new infrastructure investments" are actually made mainly into traditional infrastructure projects in terms of investment volume. In fact, new or not, infrastructure investments are good for the economy as long as they go to the right places. One prominent problem of the investment in infrastructure is making wrong choice about which project and how to invest. It is unlikely to go wrong if the money is invested into metropolitan areas.

Returning to the reality, the development of metropolitan areas faces many ideological and policy constraints. Recently, the Central Committee of the Communist Party of China and the State Council published the *Guidance on Establishing More Sophisticated Market-based Allocation System and Mechanism of Production Factors*, the core of which is to promote the free flow and market-oriented allocation of production factors including land, labor, capital, technologies, data, etc. The document received an overwhelmingly positive response. It is no exaggeration to say that this document was released at an opportune time and hit the marks of many mechanism problems facing the development of metropolitan areas. It also proved that substantially deepening reform is the best stimulus policy.

We should take the opportunity of the implementation of the top-level document to launch a reform and development package to promote the development of metropolitan areas through the marketization of production factors. The package should focus on metropolises and city clusters with continuous inflow of people and huge development potential. Meanwhile, we should accelerate the formulation or amendment of the development plans for metropolitan areas and publish them as early as possible, to shore up confidence and stabilize market expectations. Besides, we could start the construction of well-prepared infrastructure projects including rail transport in metropolitan areas and communication engineering projects; draw up plans and commence the building of affordable housing in stages, targeting migrant population, especially rural migrant workers in cities; promote rural housing land transition, and select several small towns to pilot the development of retirement communities for elderly people from core cities; and adjust the household register policies and migrant population management policy to create favorable environment for migrant population to live, work and start businesses in small cities and towns within metropolitan areas. Guangdong-Hong Kong-Macao Greater Bay Area and other promising provincial capitals may be chosen as comprehensive experimental zones for the reform and development of metropolitan areas, the experience from which may be copied and promoted to other areas afterwards.