Accuracy

INDUSTRIAL POLICY AND A FOCUS ON CHINA

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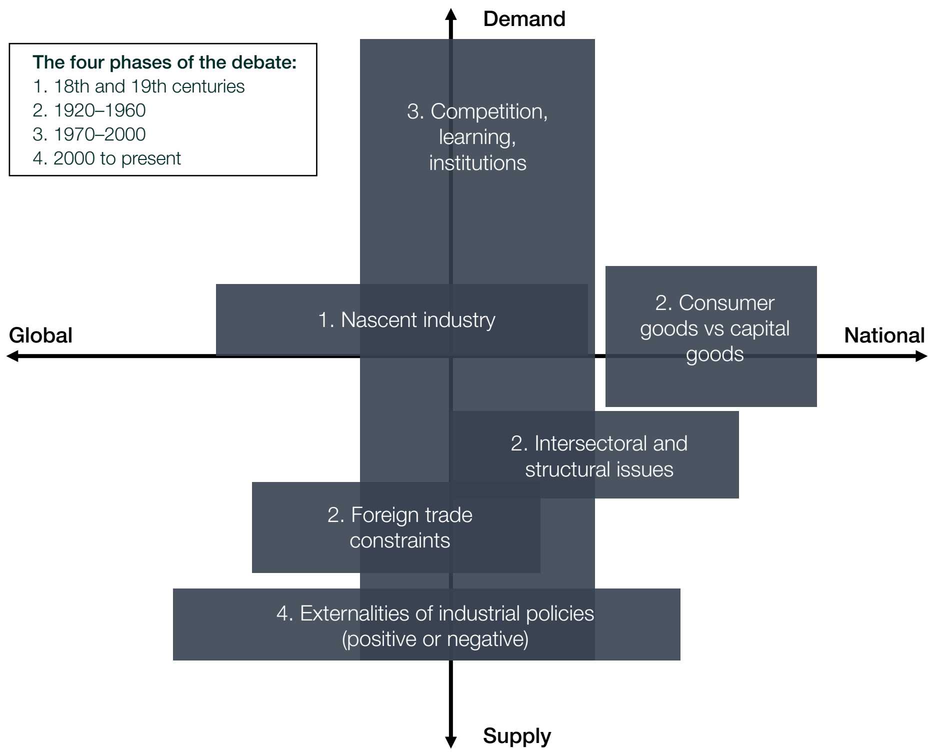
In light of the huge industrial programmes announced recently in both the EU and the US, in this edition of the Economic Brief, we will provide a brief overview of the history of industrial policy and the four key phases to bear in mind that may influence policy in the future. We will then zoom in on China to examine its current economic activity and how the government is handling its economic and foreign policies.

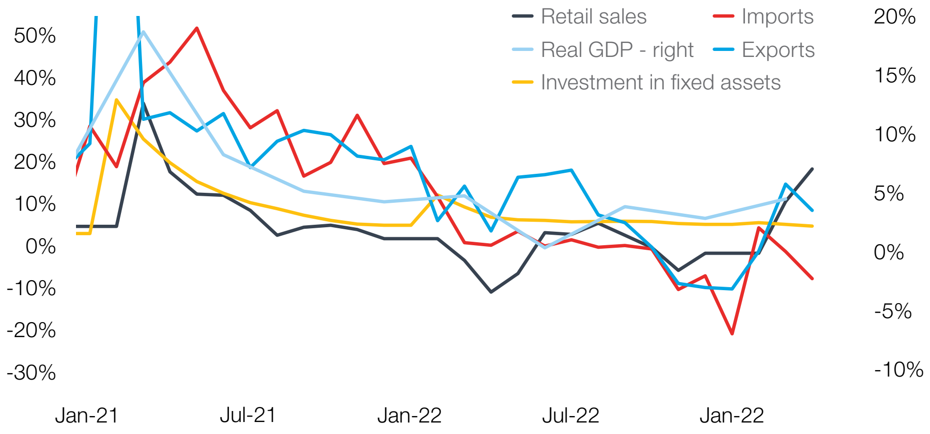
The four phases of the debate on industrial policy: key themes



Sources: Accuracy based on Andreoni et al.

With the announcement of huge industrial programmes by both the US and the EU recently – namely the Green Deal Industrial Plan, aiming to make Europe the leader in net-zero technologies, and the CHIPS and Science Act and Inflation Reduction Act, broadly aiming to reinforce the US semi-conductor industry as well as to reduce greenhouse gas emissions and the cost of access to healthcare in the US – it is worth looking back at the history of industrial policy, a highly fashionable concept at present. Four key phases come to mind: the first, from the 18th and 19th centuries, introduces the concept of nascent industry, which complements others such as division of labour and comparative advantage; the second, from the 1920s to the 1960s, delves further into the idea of nascent industry – not all goods are the same (consumer goods vs capital goods), and intersectoral implications and relations with the rest of the world must be considered; the third, from the 1970s to the 2000s, incorporates microeconomic and institutional aspects, considering competition, learning, government intervention and conflicts of interest; and the fourth, which continues to the present day, focuses particularly on the efficiency and effectiveness of industrial policies taken – something that requires consideration of all the progress made in the previous phases.

Growth in China: strong Q1 and weak Q2?



Sources: Accuracy & Macrobond

Let us now look to China to understand its recent economic performance and priorities. The graph opposite shows a split of China's economic activity by major component. We can observe a net improvement in the first quarter of 2023; this follows naturally from the discontinuation of China's zero-Covid policy, which severely hindered the country's economic activity. In the second quarter of 2023, we see a slowdown in imports and exports, and investment in property remains mediocre. The graph appears to show that retail sales (consumption) might be China's saving grace when it comes to economic performance. However, we must remember that this is a year-on-year comparison; comparing the activity of the second quarter of 2023 with the anaemic activity of the year prior (lockdowns) fails to provide much comfort. It appears that we cannot extrapolate China's rebound in the first quarter across the rest of the year.

What does this mean for China's economic policy? For the Chinese government, it is a question of supporting the activity, but not to excess. Supporting growth must be considered more of a priority than pushing through reforms. However, the government is not recklessly loosening its purse strings: public budgets are set to fall slightly in 2023 as a percentage of GDP, and monetary policy will remain prudent. The Chinese government must maintain the fine balance between supporting the economic recovery, whilst avoiding macroeconomic imbalances and taking on too much debt.

China's foreign policy must also take into account its economic constraints. Chinese isolationism is not the ideal response to today's challenges: indeed, China requires access to foreign technology and so must maintain friendly relations with Europe and must at least limit tensions with the US. Russia also remains an essential partner for China; not only does it provide enormous supplies of resources – both natural and defence-related – but it also boosts China's influence in the Middle East and Africa. Finally, Russia helps China stand in opposition to the US; for China, Russia cannot lose the war in Ukraine, risk undergoing structural change and, in the process, becoming more westernised. Maintaining the balancing act between not antagonising the West too much and bolstering Russia is no easy task.

China's economic outlook, much like that of the West, remains uncertain. Its recovery in the first quarter of 2023, generated by the end of its zero-Covid policy, quickly came to an end in the second quarter of the year. It remains to be seen how the country will adapt its economic (and foreign) policy to support its economic growth in the future.