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A conflicted China forces more clarity in Australia

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With the world's stock markets reeling after their worst-ever start to a year, it is important to remember that the adjustments at the heart of the current turmoil are inevitable and desirable. But that doesn't make them any less dangerous. And as the threats mount, strengthening our economy's capacity to withstand a global downturn becomes ever more urgent.

Nowhere are the problems clearer than in China, whose woes lie at the centre of the storm.

That China's economic expansion — which saw its per capita income rise twelve-fold in less than forty years — could not continue at close to double digit rates of growth was eminently predictable. So too was it predictable that once the wasteland left by

Mao's Cultural Revolution had been replaced by a forest of super-fast trains, multi-lane highways and gravity-defying skyscrapers, China's infrastructure splurge would taper

And China's leaders themselves have long stressed the need to reduce the economy's reliance on investment-led growth, internationalise its financial system and allow markets, rather than bureaucrats, to determine the allocation of capital.

But China's own achievements have made managing those transitions far more difficult, giving rise to significant downside risks.

To begin with, the complexity of China's political system is much greater today than it was when Deng Xiaoping began the process of economic liberalisation in 1977-78. That is not to deny that China remains a brutal one-party state; nor could anyone deny that Xi Jinping, the President of China and General Secretary of the Communist Party, has moved to recentralize decision-making.

But it is also undeniable that authority is no longer monopolised by a handful of leaders who command enormous respect, as was the case in Deng's day. Rather, power has become more dispersed, while the mechanisms involved in setting policy are more regularised and incorporate a far wider array of interests.

In a democracy, electoral competition would ultimately select among the options those contending interests champion. In China, however, that selection is less clear cut, with the country's size and diversity adding to the lack of clarity and aggravating the frictions involved in policy implementation.

But just as the political system has become messier, the economic challenges the country faces have become more daunting. Although Deng was a masterful political tactician, his task was facilitated by the scope the tabula rasa he inherited gave him to proceed incrementally and on a tightly controlled scale.

However, once the price mechanism, with its ultra-sensitive antennae, becomes as pervasive as it now is in China, market forces, when unleashed, inevitably prove difficult to corral, causing half-measures, such as the partial liberalisation of capital movements, to more readily come unstuck.

Today's problems are therefore symptoms of how far China has travelled from a

Soviet-style economy and society. And it is surely obvious to China's leaders that simply turning back the clock, as Leonid Brezhnev, then Secretary of the Communist Party of the Soviet Union, did at enormous cost in 1964, is not on the agenda. Yet the same forces which rule out any reversion to top-down control make it harder for a coherent policy stance to emerge and persist.

Compounding the confusion is the absence of any real consensus on the pace of change. With living standards no higher in 1977 than in 1957, there was, in the lead-up to Deng's initial reforms, little doubt something had to be done; now, however, in an economy still growing more rapidly than most, the task is to place priorities on many contentious trade-offs, such as that between closing down inefficient, labour-intensive, firms and maintaining social stability.

With sharp differences about those trade-offs, it is hardly surprising that recent months have been marked by false starts, contradictory pronouncements and sudden reversals in virtually every area where change is needed.

One moment, for example, senior officials hail progress towards market-based setting of the exchange rate; the next, they quash the Hong Kong market for the Yuan, which had the defect of not being subject to tight controls.

Equally, one moment, the central bank announces it will not to renew a large line of credit to a major bank and let the Yuan weaken; then, when the Yuan does precisely that, it executes a 180 degree turn, and injects into the markets the exact amount it had, merely twenty-four hours earlier, conspicuously withdrawn.

And just as President Xi is quoted as saying that China "cannot rely on fiscal stimulus to achieve its growth targets, otherwise the country will create new problems", evidence emerges of a substantial fiscal easing, some of it going to the very "zombie companies" the President had promised to shut.

Little wonder investors question where the country is heading. And little wonder too that as concerns about China mount, so do fears about the commodities its growth had sustained, with the dramatic falls in oil prices — which Iran's impending re-entry into world markets will only worsen — deepening the panic.

The result is unlikely to be a crisis as systemic as that which gripped the North

Atlantic in 2008. There are, after all, no signs of financial markets freezing, as they did when the house of cards built out of derivatives contracts piled on top of junk bonds started to implode. But the fallout could well be less localised and more persistent than that caused by the 1998 Asian financial crisis and the "tech wreck" of 2000-2001.

And with global growth rates already low, monetary policy as loose as it could be, and budgets stressed to the breaking point, governments worldwide have far less room to respond than they had then.

That makes it all the more crucial for the Turnbull government to frame a credible economic strategy: not one based on tax slugs that would stifle growth but on genuine efficiency-enhancing reforms. With China no longer there to save us as it saved Kevin Rudd, 2016 requires not rhetoric but action.