



**Anthony Saich**  
**What Does General Secretary Xi Jinping**  
**Dream About**  
(Summary)

Date: 3 October, 2016

Venue: CIGS Meeting Room, Tokyo, Japan

Professor Anthony Saich, Harvard Kennedy School: The economic rise of China is reshaping geopolitics, and there is a divergence of views about how one should accommodate that increasing rise. There are two important factors to consider. One: for the first time, the world's largest economy will not be a Western nation, and it will be a nation whose leadership does not hold the same values as the West. This has led to conversations about shifting policy in the US. And two: for the first time, the world's largest economy will neither enjoy the highest living standard nor the highest quality of life. China is dealing with large pockets of poverty, leading some in the West to question their political stability.

This leads us to ask: what does Xi Jinping dream about? Is it a realistic dream? Has it turned into a nightmare? Is China's economic growth sustainable, and what are the possible scenarios for China's future?

Looking at Chinese political priorities, it's quite clear what Xi Jinping has been laying out. He saw economic turmoil taking over China, so he reacted by accumulating power and dominating the political discourse. It was crucial for politics to overtake economics to continue China's progress. Although, since 2012 when he took power, politics have been frozen, economic and institutional reforms seem to be frustrated by vested interests inside the Chinese Communist Party (CCP), and there is a fruitful resistant to political liberalization.

Xi Jinping has broken away with existing norms to find a new basis for CCP rule. If one looks closely, it's possible to see six clear priorities in this strategy. The first one is the revival of traditional Chinese culture, with a special emphasis on Confucianism. This is surprising, because the dominant narrative had been that Confucianism was taken to Taiwan, while the CCP would provide a new set of relationships for the mainland. Some people have been comparing Xi Jinping to Mao Zedong, but upon closer inspection he is more like Liu Shaoqi due to this emphasis on moral strength.

The second priority, alongside this renewed stress on Confucianism, is a reestablished importance on Marxism. This came about as an effort to shift the party members' focus to GDP growth. Furthermore, this has led Xi Jinping to downplaying the pomp and circumstance of politicians' behavior; now government functions are frugal affairs, the third priority.

The fourth priority is a focus on increasing government credibility. The last three Chinese regimes have been accompanied by the removal of political opponents under

claims of corruption. China has had to shift its legitimizing mechanism for how to remove people from power. This is not to say that genuinely corrupt targets are being removed under the current regime.

The fifth priority is about stronger control over state and society. Xi Jinping is proud of his achievements and criticizes those who seek to undermine the CCP's image. There is now a tendency in Chinese writing to separate the Mao years from the post-Mao years. China has also been very successful at controlling information flow on the internet, including spreading its own message.

Nationalism and its promotion act as the sixth priority. The more assertive postures in the South China Sea are indicative of this, and criticism against the actions of the CCP have become unpatriotic. It should be noted that these policies did not necessarily originate with Xi Jinping; he inherited an expansionist policy from the 2008-2009 leadership, when China hosted a successful Olympics, bore witness to the economic crisis spurred on by America, and saw its 60<sup>th</sup> anniversary. In fact, there was a dominant view in China at the time that the American economy was finished.

There was a very important document written in the early 90s after the collapse of the Soviet Union called "Realistic Responses." The group that wrote this document is the current generation in power, including a former head of a Chinese Government Bank. The falling of the Soviet Union was actually a relief to this government. Now, China and the West aren't required to get into ideological struggles, but can instead base their policy on their national interests going forward.

Turning to the economy, both Chinese and US analysts agree that the past model is no longer viable moving forward. Liu Shijin, the former Vice Minister of Development Research Center and the State Council, wrote, "The end has come to the period of purely quantitative expansion and of extensive cultivation for meager returns." Priorities two or three years ago focused on the shift to consumption as the key driver of sustainable economic growth, but there is now an emphasis on supply side policies, including investment in China. However, it's hard to see how this investment could expand further without beginning to see diminishing returns. The export profile of China is more like smaller economies like Taiwan or the ASEAN countries rather than a full continental economy. This means that the shift in consumption will be a key driver for growth.

President Xi has stated that the Chinese economy must grow by 6.5%. This is not going to happen. It is very clear that the state-owned sector will still remain preeminent, despite talks of reducing its role. There are talks about increasing small- and medium-sized enterprises, but this is not akin to the levels of privatization that are seen in the West. Perhaps President Xi sees state-owned enterprises as the key of CCP rule, as current policy intends to make them more efficient and provide greater returns for state profit. The catalyst for this idea came from his time in Shanghai, when he saw that he could restructure state-owned enterprises in a way that would play a progressive role in the moving forward of the Chinese economy.

Financial sector reforms have also been quite important. At first there were talks of cleaning up the too-big-to-fail state banks that led into talks about exchange rate reform, interest-rate liberalization, capital account convertibility, and renewing internationalization. These are politically difficult, so in practice we're seeing the reverse: the internationalization of the renminbi (RMB). This is something that people can gather and rally around, and if there is anything within the Chinese policymaking apparatus that can make reform in the real economy happen, it will be the smart minds within the financial sector.

This is not a new agenda, however. These are the same policy priorities that Hu Jintao-Wen Jiabao administration laid out in 2002-2003. The question is, really, where has the current regime been more successful than the past regime?

It's clear that Xi Jinping is a much stronger and more confident leader than Hu Jintao. President Xi, unlike his predecessor, created a vehicle to push the reforms through at both a national and political level. There were 60 priorities associated with this decision, creating challenges for implementation. On a local level, officials responded by addressing the priorities that seemed most applicable for beneficial for their constituency, simultaneously ignoring those that might have conflicted with the embedded community interests.

There is another question about the tradeoff between economic growth and environmental degradation. This presents another challenge for the CCP, because this is a direct result of their policies and growth, but the result has begun disturbing the ever-growing middle class in urban Chinese communities. On one-hand, pursuing economic growth has produced very strong vested interests with strong winners, but at the same time the anticorruption campaign weakens the ability of local officials to push forward reform.

In the 1980s, it was obvious that there was a coalition of interests to push a wave of reforms through, with the same thing happening in the 1990s in Southern China. But now, many of those in the core of the CCP feel threatened by these reforms. A new coalition needs to be built while holding the party together; if this is not accomplished, then the party could fail. It's a very difficult and risky situation.

There are external barriers that could further increase integration advances, including the general health of the world economy, which is very important for China's export sector and how other countries will continue responding to China from now on. Currency disputes, trade disputes, and ill-informed politicians (a la Donald Trump) all present potential disruptions for China's reforms.

Another economic issue facing China is its potential fall into the middle-income trap within the next 5 to 10 years. To prevent this, comprehensive reforms need to be pushed ahead. South Korea and Taiwan show that success is not easily attributable to just the absence of state regulations. It is the specific nature of regulation and interventions that lead to a competitive framework for growth and export. But does China have the necessary faculty for constraint, or will it be controlled by vested interests?

There is a strong empirical relationship between the quality of institutions and economic growth. Most of the countries who come out of the middle-income trap have better functioning institutions. It would be easy to assume that economic growth would lead to better institutions which would lead to more economic growth, however Vietnam and China both have good institutions for their current level of economic growth, but these become problematic at the higher level. In both higher level economic and political institutions, it's necessary to promote productivity growth rather than simply increasing capital – a specialty of the Chinese system up until now.

While China's current institutions are sufficiently flexible to allow them to break out of the middle-income trap, there are concerns surrounding the slowing growth rate. Xi Jinping's dream of 6.5% growth per annum is not going to happen. Actually, it will happen over the next couple of years, but the problem is what happens when the system can no longer keep pace with the reforms that will be present in next year's political transition.

Measuring these changes can be difficult, as income growth is a poor predictor for growth slowdowns. Rapid growth may actually be a more powerful predictor of slowdown than income level. However, income level may have a correlational relationship to slowdown. The GDP on PPP basis at the point of slowdown is roughly

\$13,000. In Japan, the economy slowed down when it hit \$13,800; in Taiwan, it was \$13,400. In 2015, the PPP for China was at \$13,200. These slowdowns are expected.

However, China has a much higher level of inequality coupled with much higher investment, infrastructure, and organization needs. This means that, ultimately, President Xi is not going to reach 6.5% growth by 2020 – but despite this, China still represents an \$11 trillion economy. Even a 4 or 5% growth would be quite effective for China.

Demographic dividends propelled growth up until very recently. Labor has hit its largest capacity and can only shrink from here, so now there are diminishing returns in many over-capacity sectors. There are three possible results that could result from this. The first is maintaining 6% growth through significant investment, but this investment will need to be redirected to sectors of economy that are more plausible and beneficial in the long term, while additionally being redirected toward a productive use of China's finances to counter shrinking human resources and capital.

Many Chinese economists have become negative about short and medium terms for potential growth in China's economy. This is in contrast to the prevalent attitude that America is in decline, and that China should be aggressively pursuing the reigns. It seems that international relations professionals simply aren't reading what their own economists are writing about.

Even though President Xi is talking about rejuvenating the Chinese Nation, this doesn't present any significant changes for the rules of the game. He doesn't want to confront the US; he's happy with the current multi-polar status quo. A continually developing peaceful environment takes precedent over starting conflict with the West, especially considering some of the problems of overcapacity. Still, the current foreign policy is different than Deng Xioping's previous admonition of "hide your strength, bide your time, never take the lead, and accomplish things where possible." President Xi's China is more assertive and is looking to reassert (what it sees as its) traditional dominance within the region.

Their diplomatic priorities lie around building a "community of shared destiny centered on China" by exerting pressure on neighboring countries. Examples of this include the BRICs bank, AIIB, and the use of One Belt One Road. Through these policies, China has taken over the role of a regional funder, a role once occupied by the US and Japan.

Other issues causing enhanced security relations with the US include differences over Taiwan and the Korean peninsula. This could further cement the developing bifurcation of Asia into two blocs: one formed by the America-led TPP and one formed by the China-led free trade area in the Asia-Pacific.

Among potential outcomes, there are three that seem most likely. The first is the continuation of the fluctuation of soft and hard authoritarianism. There are those that say that Xi Jinping's primary concern is increasing his own power, but this is not likely due to the difficulty in attempting this in the Chinese political arena. The status quo that we're seeing now is a technocratic approach where the leadership is trying to maintain an authoritarian political structure coupled with the continuation of modest economic liberalization. General friction with the US and Japan will likely continue under this scenario.

The second outcome takes a view that transitions are rarely accompanied by economic growth, which makes forming new coalitions problematic. This would most likely result in a Putin Russia-esque illiberal democracy, where the executive branch dominates with the support of the military. This would give rise to new economic elites within the party who would resist political opening. Relations with the US and Japan would be fragile and unpredictable under this government.

The third scenario is the most optimistic outcome for America, but it is not necessarily the most likely. The government would move to create reforms to accommodate and increase diversity within society. Other nations in Asia have followed this pattern (the pattern of authoritarianism, democratic breakthrough, economic growth, and ending with the rise of the middle class), but it is unlikely to occur in China unless large swaths of the ruling elite suddenly become comfortable with breaking from tradition. The role of the middle class will be important, and marketization will legitimize the rule of law – but there's no reason for the ruling class to submit to these types of changes. A variant of this scenario would see a breakdown of a power elite, only to be replaced by a continual rise of oligarchs from the politically well-connected. Assuming the variant does not happen, this outcome would lead to a greatly improved international climate, including reduced tensions with Japan and America, and introducing a potential route for reunification with Taiwan.

**Kurihara:** It was a really impressive argument about China's modern institutional configuration and the bifurcated politico-economic zones in Asia. We will now have questions. Please state your name, accreditation, and ask your question.

**Questioner1:** Originally the US thought that China's economic growth would lead to a democratization of China. What we see now is a much stronger communist party than in the past. Why did that assumption go wrong?

**Prof. Anthony Saich:** Several other people have thought about this, and I think you're right. These unrealistic assumptions about economic increase that would lead to political change are secondary to what the US was trying to achieve in terms of building closer economies and trying to control China's behavior. In the Reagan and Bush administrations, there was a belief that China's economic development would result in increased engagement in a number of other institutions. This has not been true. Specifically with the WTO, there are different responses from the national, provincial, and local governments. The national government must abide by international treaties, so they have moved legislation to progressively integrate with the WTO. At the provincial level, interests begin to diverge as officials work to protect their respective province's industries. This is further diluted at the local level. It was not very well thought out how the WTO policies would affect all levels of the economy. China has benefitted from the WTO regulations, but not as much as we thought. And now, actually, it threatens to overtake us. The amount of private wealth has exceeded everyone's expectations. A lot of state patronage combined with individual entrepreneurs filling in the gaps create monopolies, forming a type of dynamism.

**Kurihara:** If you look at people though, it seems that they are now very liberal-minded. It seems that the US assumption was half right. Through economic liberalization people thought to push these ideas forward, but it seems like China wants to control this social liberalization.

**Prof. Anthony Saich:** The word is conflicting objectives. By entering the WTO, China could bring in external mechanisms, which is convenient, because if something goes wrong, then it's possible to just blame foreigners. Liberalism is winning the battle on economy in terms of expanding the realm of personal freedoms, but it's not creating a freer state. From the Cultural Revolution until now, there has been nothing but continued improvement. People can now buy houses, travel freely, and have better general material conditions. There is no vibrant civil society, but things are better.



**Questioner2:** I have two questions. Do you think that Xi Jinping resembles Mao Zedong? Can you elaborate on that? Why didn't you include a more chaotic disintegration of China in your potential scenarios?

**Prof. Anthony Saich:** I briefly described this. It might be a liberal democracy, or it might be a chaotic quasi-disintegration ending in an oligarchy where different groups control different parts of the economy. This is a real possibility. There are other chaotic situations, such as the emergence of a weak leader, a military taking control, or a security apparatus similar to the one that Putin employs. I compared him to Liu Shaoqi, who was president when corruption was low and there was a link between correct behavior and Confucianism. This allows him to talk about Confucianism without falling into a trap. He can venerate parts of Mao without dealing with the effects of the Cultural Revolution. He also sees that the CCP needs the type of discipline that will allow him to pursue structural reforms.

**Questioner3:** With the background of Japanese-Chinese relations in mind, does China expect Japan to be in the sphere of interest of China? And how would the US see this?

**Prof. Anthony Saich:** Recently I think President Xi Jinping has realized the danger of growing anti-Japanese sentiments within China. Japan's contribution to China's development has been great, considering the engagement of Chinese companies in Japan, the role of groups like JICA, and general support given. There were good relations until 1989, when student demonstrations prompted the Communist Party to push for a huge patriotic education programs. China needed enemies for these programs, and Japan and the USA were good targets.

There is now a generation of Chinese young people who have grown up with these messages reiterated on the media. A lot of these issues were open until the 1990s, but now there is an atmosphere where it's very difficult for the senior leadership to deal with Japan. They're trying to always balance appeasing local anti-Japanese sentiment while maintain diplomatic relations.

In the long term, China feels that Japan should accept its dominance within the region. It won't be able to sever the relationship with the US, however.

**Questioner4:** The West is economically wed-locked to China in terms of economics while simultaneously having a confrontational relationship in terms of security. Are there any efforts to forge a strategy to resolve this conflicting relationship?

**Prof. Anthony Saich:** Policy hasn't changed significantly since the 70s. There have been talks about the butchers of Beijing or reuniting with Taiwan, but these have all been fruitless. There are some new elements, like jobs. Is China taking jobs from America or not? This is an important issue in domestic American politics, despite the fact that robotics and other manufacturing shifts are more responsible for the loss of jobs than China.

Japan was buying things when it became an ally of America, while China is not. This is creating a difficult trade scenario. There are also problems in the business community. The European business community has become much more critical of the treatment they're receiving from China, making it difficult for the US administration to simply deal with China. America will probably frustrate China's interests, but there are new areas in terms of global commons, global engagement, and global regulation that must be considered.

If manufacturing comes back to the US, it will only be a 10-15% cost differential. These jobs won't come back, however, because of automation processes.

**Questioner5:** China has a population of 1.4 billion people, but they experience a brain drain of 1.5 million people a year. These people would be responsible for developing the Chinese economy. What policy do you think China will pursue to curb this effect?

**Prof. Anthony Saich:** There are a number of reasons, but an important point is that not all people leaving are highly educated. There are 600,000 Chinese working in sub-Saharan Africa in the non-safe sector, many of them small traders. One thing driving people overseas is the long term stability of currency. People are concerned about protecting their assets and investments more than their potential profit. There are 300,000 Chinese students in the US at the moment, which is a failure of the Chinese education system. It's not the brutal nature of the entrance exams as much as the quality of the education that isn't preparing people on a global level.

People are leaving, but are they more democratically inclined? Actually, they are attracted to sources of stable income, a better life for their children, and a system that can encourage both of these. In some cases, there is a risk of the Chinese embassy hearing about unpatriotic behavior, resulting in cautious behavior by students and expatriates. This is not a complete answer to your question, which is very complex.

**Questioner5:** Then this won't have a negative impact on the Chinese economy in the future?

**Prof. Anthony Saich:** It's a small number, and there's plenty of money to be made in China. We've seen it in Taiwan and Hong Kong. Recently I've seen more of my students return to China to create jobs.

**Questioner6:** How does the current Chinese leadership view their relationship with Russia? Will it be closer in the future? What is Beijing's reaction to the current warming in relations between Russia and Japan?

**Prof. Anthony Saich:** I can say that for both China and Russia, their relationship with each other comes secondary. External events push them together or pull them apart. It's not likely to be a long-term strategic relationship.

**Questioner7:** Do you think Confucianism will play an important role in policymaking in China, despite common people being unfamiliar with the concept? Do you think Xi Jinping is pressuring local governments to implement the central government's policy? My last question is about the three scenarios you talked about. Which scenario do you think China is most likely to see?

**Prof. Anthony Saich:** Confucianism is directed toward the elite, because the Confucianism being promoted now is just a caricature. The idea of hierarchy is being used, but I'm not sure it plays a role in policymaking beyond that. There are varying ideas of how Chinese society organizes itself, either vertically (like Confucianism would suggest) or horizontally (which would be more akin to Darwinism).

To answer your second question, China has done a poor job of communicating ideology to central directors while simultaneously trying to control local behavior. Experimentation at the local level has led to successful reforms over the past 30 years, but there are two dangers now. One is controlling the local governments too much. Will they be able to experiment properly to evolve? The second is bureaucracy. Officials just don't know what to do anymore, because the framework is unclear. President Xi Jinping needs those local officials, but they're paralyzed due to strong anticorruption campaigns and top-down pressure.

I think the first scenario is the most plausible, given the circumstances, but scenario planning means you should have a strategy to deal with all of the situations and never

rule anything out too soon. What if the party stays in power for another 10 years? That's another scenario we need to consider.

**Questioner8:** After a country's GDP for PPP becomes more than \$13,000, it experiences slower growth. Under long-term economic pressure, how will the CCP keep their legitimacy in China?

**Prof. Anthony Saich:** China is already about \$13,000. They will be confronting these issues soon. In the past the CCP has based its legitimacy on being able to deliver economic results, so if it can no longer do that, does it become vulnerable? In China, 3 to 4% growth is still not bad. It still creates opportunity. Policy mistakes could pull it down. Nationalism tipping over into xenophobia is an example. But if the CCP is not there what would replace it?

In Hungary, when the situation was advantageous for leadership to make a reform (good economic conditions, high public satisfaction), they didn't. This caused the Hungarian government to lose support. This is a real fear for China too.

**Questioner9:** In China, the growth rate is likely to go down between 1 or 2% for 3 or 4 years. What do you think about this?

**Prof. Anthony Saich:** China's economy is normally well-protected from external shocks. Its financial system is well insulated, which is not the case for Thailand or Malaysia. This means special attention must be paid to the financial sector when we look at potential reforms. If China can begin to clean up its banking practices, then it will be in a better position to deal with big shocks in the future. We won't see these reforms in the next year or two, because President Xi Jinping must retain his government's position. We're going to see the debt to GDP ratio go up very high, potentially as much as 250, and certainly above what the OECD flags as dangerous levels. If this happens, all bets are off.

**Kurihara:** The political longevity of the CCP, combined with the bifurcation of the political and economic landscapes, gave us a lot to consider. Technology will make things increasingly complex, so we should continue to consider China's perspective.