The Canon Institute for Global Studies

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"U.S.-China Politico-Economic Relations under the Treacherous Global Circumstances"

Anthony Saich

“Xi Jinping’s Policy Challenges”

(Summary of speech)

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Anthony Saich, Professor of International Affairs, Harvard Kennedy School:
I will talk generally about some of the key policy challenges and then link some of the domestic and external issues. In some ways, the Xi Jinping leadership has been much more explicit about its objectives. That is in part a continuation of trends that began under previous leadership following the global financial crisis, which undermined the credibility of the U.S. in the eyes of some in China. Ironically, as China has begun to meet international demands by being more explicit about its aims, there has actually been quite a considerable counter-reaction to it in the West.

Domestically we see, for example, the articulation of Made in China 2025. This is to make China the master of its own technologies and gain self-sufficiency in important advanced industries. However, there is concern from foreign businesses that China is favoring its own companies in the domestic market and subsidizing the acquisition of foreign technology. They question whether the playing field is really level.

China has often justified these measures by saying that it has restricted access to the necessary high technology. Meanwhile, many countries have expressed concern over Chinese practices, including those that lead to severe overcapacity or create unfair competitive conditions.

Internationally as well, Xi announced that by 2050, China will be a global leader in terms of composite national strength and international influence. He has also reemphasized foreign policy with Chinese characteristics, and spoken about global community and common destiny. This has shone a spotlight on the Belt and Road initiative (BRI) and concerns about the actual aims. China portrays it as contributing and building on existing structures, whereas U.S. analysts see more sinister designs to create parallel institutional structures.

Xi has said that he is not willing to acquiesce to the U.S.-dominated global order and indicated China's intentions to reform the global system. The key to this has been the formation of the Asian Infrastructure Investment Bank (AIIB).

First, I want to examine some domestic governance challenges. When Xi came to power, he focused on combating corruption and restoring public trust. There has been some success with that. Our surveys of public opinion show signs of recognition among

Chinese citizens for these efforts. More recently, citizens have been unsatisfied with land management and environmental governance.

Xi has delineated two key priorities: poverty alleviation and environmental clean-up. While there are clear challenges in the economy, the most enduring long-term challenges relate to governance. Interestingly, our surveys show that Chinese people disaggregate government. They are highly satisfied with the central government, but satisfaction falls at each level of government below that. Citizens tend to blame the local governments for the problems they see.

The government has been trying to respond to these challenges, and the leadership has put forward the notion that the Chinese Communist Party needs to shift from being a revolutionary party to a ruling party, i.e., putting the people first. However, many of the reforms that were taking place under the previous leadership have clearly been rolled back. The leadership is attempting to restore the prestige of the party through the campaign against corruption and greater frugality, but at the same time, this will be a top-down process and the system will not be opened up to scrutiny from the public or an independent press.

Clearly, there are barriers to meeting those objectives, including the general health of the global economy and how other countries interpret Chinese growth and practices. This could lead those countries to set up barriers to trade similar to the actions of the administration of President Trump.

As many Chinese companies tend to go global, this is going to become an increasingly pressurized issue. In the U.S., there has been a very significant shift in the attitude and appreciation to China, even before the start of the Trump administration. Many traditional supporters of the relationship have become much more negative. Quite wide-ranging coalition of groups have become extremely critical. This change in attitude is likely to remain in the medium-term and possibly the long-term.

The U.S. and China are drifting apart. The norms that upheld several decades of U.S.-China relations have been broken and no clear new strategy has emerged. The Trump administration’s response is a set of criticisms that does not amount to a real strategy. Nevertheless there has been a clear shift from the years of strategic engagement to strategic competition. This is expressed very clearly in the 2017 National

Security Strategy. Vice President Pence has also made it very clear that this is a broader issue and not just a question of trade and tariffs.

There is also another domestic set of issues with serious international relations consequences. The new leadership needs to transition the governing structures from those of a communist state and a planned economy to a more modern market economy that can accommodate a pluralized society. There are two key points. Firstly, what nature of institutions can help China move to the next level of growth and get beyond the middle income trap? The second is the challenges of centralization.

Regarding the first point, David Dollar, a former head of the World Bank in China, has linked institutions and growth. He claims that there is a strong empirical relationship between the quality of institutions and economic growth, citing examples from Taiwan and South Korea. Countries such as China and Vietnam have extremely good institutions for their current level of economic growth. Consequently, they have attracted high levels of foreign direct investment. However, as incomes rise, it becomes more difficult for authoritarian regimes to maintain growth because the economic system starts to need institutions that promote competition, innovation and productivity growth, rather than simply accumulating increasing amounts of capital.

That requires a significant shift. Studies suggest that countries that have broken through the middle income gap tend to have much better quality of governance scores. On the whole, China has a very long way to go to match South Korea or Taiwan, let alone Japan. Again, this raises the question of what kinds of institutions make for better economic growth.

Regarding the centralization of power as a development strategy, when Xi took power, there were various corruption and other scandals, and society and local government institutions seemed to be heading in the wrong direction and pursuing their own interests. It is therefore understandable that he would want to centralize power within the party. Xi's approach to dealing with this is in very stark contrast to previous leaders who had a much more decentralized and flexible approach to governance. One might call it "soft authoritarianism." While it did perhaps lead to corruption and appear institutionally fragile, it also produced a much more flexible party-state structure. I think that is important because reforms are often influenced by society and local experimentation.

Another important factor is the current thinking of the leadership. Deep within the culture of the communist party is an attachment to the notion of the collective. One of the fundamental beliefs is that individuals will get more from being part of the collective than acting individually. Of course, the challenge is that markets are much more about individual wants and needs. That clashes very strongly with this belief in the collective. For example, there has been resistance to the rise of the private sector as a major generator of growth and employment.

Meanwhile, Xi’s rule continues to concentrate more power at the center. There has been centralized control over domestic and international economic activity with clearer national industrial policies to favor the state-owned sector. One of the most interesting examples is the relationship to the high-tech sector. Essentially, the Chinese government realized that it did not have the capacity to develop high-tech sectors, so it basically outsourced it to the private sector, and built barriers around it to protect it and enable it to grow rapidly without foreign encroachment and competition. Now, however, it is reasserting control over that sector, such as through state-owned enterprises gradually taking over private enterprises, etc.

This has affected global business approaches. Going global will continue to be the centerpiece of BRI but with the state sector in a dominant position to the private sector. The private sector was seen by many in the leadership as overpaying for the assets that it was taking on and not investing strategically. So, state-owned enterprises will be at the core, supported by a number of financial institutions. In relation to this, many people talk about the AIIB. However, the real driver is the China Development Bank, which is much more closely associated with the interests of the state-owned enterprises.

To retain support, the administration has put in place policies of redistribution and greater investment in social welfare and poverty alleviation to dampen negative social impacts. According to our surveys, that seems to be having an effect. There had been a sense that regional disparities would lead to dissatisfaction and possible instability. However, our survey shows that this seems to be untrue. The lowest income groups and those in the periphery of the inland areas have had the greatest increase in satisfaction with the government in recent years, which is very closely correlated with the tangible increases in funding resources to those populations.

Now let me turn to the external dimension. Xi's biggest challenge is surely Trump. I think the Chinese are dumbfounded with what to do with him. As I mentioned, Made in China 2025 and BRI created a counter-reaction in the international community. At the same time, some Chinese defend them as countermeasures to U.S. actions. Some Chinese analysts believe the deterioration of the economy has actually come from U.S. actions involving the cynical use of international architecture that the U.S. created, such as the trade war, the attacks on the global trading system, withdrawal from the Paris Agreement, etc. Still, as I said, many foreign businesses were clearly already critical of the conditions and their experiences in China.

When the Chinese economy was less influential and less integrated into the global economy, many were willing to let that slide and not publically be critical of Chinese practices. However, we are now at a turning point and many in the business community and other communities want tougher negotiations regarding access within the China market, even if they do not necessarily support the U.S. position on tariffs. Many countries' chambers of commerce are much more critical of protectionism and intellectual property theft.

This is a problem for U.S. businesses for two main reasons. First, the stock of U.S. investment in China is more significant than that of Chinese investment in the U.S. More importantly, U.S. investments in China form an important part of the global production chains of U.S. companies, which is not true of Chinese investments in the U.S.

All the talk by the Trump administration about the massive trade deficit is a fallacy. If you factor in the profit that was taken by foreign companies, the trade deficit is reduced significantly. Interestingly, according to an American Chamber of Commerce report, although significant percentages of U.S. companies expected loss of profits, higher production costs or decreased demand due to tariffs, only 6% of those who were thinking of relocating away from China would consider the United States.

A second fallacy in the approach of the Trump administration is the idea that job loss is occurring because of outsourcing to China. Numerous studies show that the majority of the job loss in American manufacturing is because of automated procedures, higher productivity and so forth.

BRI is now included in the constitution and is the centerpiece of Xi's policy. There is enormous pressure for it to be successful. There is a risk of a dangerous bifurcation of Asia into an "Economic Asia" with China at the core and a "Security Asia" with the U.S. still at the core. The success or failure of BRI is going to be a game changer or a game breaker.

We need to revisit the assumption that China would take its assigned place in the U.S.-led international system based on free-market capitalism and near-universal democracy. In China, the growing trade war with the U.S. has fueled fundamental questions about the future of this competitive or cooperative relationship. Meanwhile, the U.S. is actually dismantling the international system of trade and exchange.

We are seeing the U.S. strategy in relation to China being reexamined. For example, a few years ago, Robert Blackwill and Ashley Tellis pointed out that essentially the U.S. facilitated the rise of China, helped China through its rise and now it has come to the point where China is the biggest threat to U.S. dominance. Therefore, a new strategy is needed that works more directly in the U.S. national interest.

Made in China 2025 and BRI are Xi's highest priorities. There is no doubt increased investment in infrastructure is welcome. However, it is difficult to define clearly the scope and role of funding agencies. It is also the case that most investment from China still falls outside of the 65 Belt and Road countries so being one of those countries is still not necessarily an advantage.

Nevertheless, as a consequence, because this is a political demand, Chinese investments might be less risk averse than other investments. In relation to this, often, when debt is not being repaid, China has turned that into equity and taken over strategic assets in other countries. This is happening in some EU countries and they have started blocking more EU measures that are critical of China.

There is also a domestic rationale. The belt into Pakistan, besides keeping India away strategically, will also help to reduce China's enormous production overcapacity. Additionally, I think China wants to see itself as a standard setter both in infrastructure but also new technology areas, thereby driving up the quality of production in China.

Some possible issues that may arise for China are, firstly, whether or not this will contribute further to Chinese debt, which is already very problematic. Also, there is the question of how Russia might respond and the impact on relations between Beijing and Moscow as a result.

Ultimately, there are six key questions to think about. Is the concentration of power what China needs at the current stage of development? Can China develop institutions that will provide feedback loops? Can it provide the kinds of institutions to facilitate competition and innovation and help China move out of the middle income trap? How will it deal with the vested interests within the political economy? Will China become a responsible stakeholder in the international order helping set the norms going forward? Can China take on the role of a key player in providing global public goods?