

Coexisting with China in the 21st Century

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Introduction

- China's economic miracle in the last 40 years is the most significant event in world history since England's industrialization in the 18th century.
- In the first decades, observers, including me, thought that some form of political reform would follow economic reform.
- Instead, China is becoming robust capitalist market economy under a communist political regime.

Introduction.

- This is an absolute new system in world history.
- What are the challenges facing a communist regime overseeing a capitalist economy?
- How stable will China's political system be?
- Will there be systems competition between communism and democracy?
- What are the chances China will overtake advanced market economies?
- Will China be expansionist?

A capitalist economy under a communist regime

- In the light of economic stagnation of USSR and lunatic Maoist economic policy, Deng thought the best way to preserve power of CCP was to introduce market economy like Taiwan, Hong Kong or Singapore.
- The old guard wanted return to 50s central planning but smart compromises led to non disruptive gradual unleashing of reforms.

A capitalist economy under a communist regime

- China's economic success is not due to state withdrawal, but to the use of power of the CCP to unleash market forces through meritocracy and decentralization (Xu, 2011).
- The economic miracle led to strong increase in power of CCP. Unequaled in history
- We have a new system of CCP power over a market economy.
- Entrepreneurs can now become CCP members.

Will China become richer than the West?

- Given its growth record, there is no reason China cannot become high income country like Japan or South Korea.
- High level of human capital and pursuit of growth should reduce the income gap with the richest countries.
- Given its population size, China's GDP will become largest in the world.

Will China become richer than the West?

- Will China overtake advanced economies in terms of GDP per capita?
- We know from endogenous growth theory that this depends on success in innovation.
- China 2025 will likely become successful in terms of production of frontier goods at cheap prices.
- I am skeptical that China will become the world leader in fundamental innovation.

Will China become richer than the West?

- 1) Research shows that countries with more collectivist culture lag countries with individualist culture in fundamental innovation (Gorodnichenko and Roland, 2017)
- China's collectivist culture gives it a comparative advantage in manufacturing coordination, but too high conformism is a disadvantage in fundamental innovation.

Will China become richer than the West?

- 2) More fundamentally, freedom of thought and expression is necessary though not sufficient condition for fundamental innovation.
- Chinese leaders have illusion they can become world leaders in STEM research while imposing complete censorship in social sciences. Hubris!
- Best Soviet scientists were critical of Soviet regime.
- Scientists left nazi Germany en masse.

Will China become richer than the West?

- This sobering idea has an important policy implication: it is counterproductive to try to sabotage Chinese innovation (as under Trump).
- Chinese innovation is not threatening, but should be good for the world economy. Closing the development gap is desirable and should create healthy competition with the West, similarly to the time of the Sputnik in the late 50s..

Challenges of the market economy for CCP

- Challenge of obsolete communist ideology?
 - Not necessarily. Haifeng Huang (2015) “Propaganda as Signalling”. Zhao Gao episode: “calling a deer a horse”. Cultural difference in meaning of communication. Lemin Wu (2015) on Confucianist etiquette.
 - The weakness is that if leaders are perceived as weak, ideology cannot be used to enhance their legitimacy. Power and not being seen as weak are the only things that matter in order to prevent challenge.
- Propaganda is effective but different from ideology.

Challenges of market economy for CCP

- Challenge of corruption:
 - Purchase of government and party positions for money;
 - Trade-off between promotion chances and bribe-taking;
 - CCP has a genuine interest in fighting corruption, but choice of market economy brings strong internal tension: communist leaders at different levels should promote growth but simultaneously behave ascetically (communist monks handling large wealth-making machine).

Challenges of market economy for CCP

- Emergence of corruption difficult to stop without enough legal economic incentives, i.e. transparent higher pay and perks.
- Anti-corruption campaign likely to dull incentives at lower levels. It is already happening.

Challenge of the private sector

- Danger of private enterprise networks controlling large wealth being independent from the party.
- Answer so far: party control inside private enterprises and cooptation of successful entrepreneurs.
- New tendency under Xi is to encourage the state sector to grow more, while discouraging the private sector.
- This could lead China back on the road to socialism.
- Fortunately, the export sector plays a key role for maintaining market growth in China.

How stable is the Chinese political system?

- If Chinese growth does not lag behind world growth, how likely is the political system to be stable?
- External aggression unlikely and would work to unite the country.
- Popular uprisings unpredictable, but there is no organized opposition able to take over the country.
- Meritocratic system leads to selection of competent leaders.

How stable is the Chinese political system?

- Leninist organizational form prevents division of CCP into factions. Only factions exist.
- New research (Francois, Trebbi and Xiao, 2017) shows how factions work inside the CCP.
- Entering one of the factions gives chances at promotion because support from higher up is necessary.
- Individuals in a high position will not support promotion of one of their own faction from the lower level to their level, because it would reduce their own chances at promotion.
- This leads to a stable equilibrium where none of the factions becomes too large.
- This is a system that emerged spontaneously, but creates stability.

CCP power over China from the point of view of standard political science.

- Those in power have always had to solve several key problems:
 1. The succession problem.
 2. The information problem.
 3. The problem of taxation.

The succession problem in China

- Mandatory retirement at 65 for CC level leaders and 68 is maximum age for PSC nomination. Age interval between 50 and 68 reduces number of candidates
- Leader chooses successor's successor: Deng chose Hu Jintao, Jiang chose Xi Jinping, Hu chose Hu Chunhua (Guangdong party secretary). Will Xi respect the rule?
- Xi Jinping is creating big uncertainty on succession rule.

The information problem in China.

- Top party leaders have always used vertical channels of information. Reporting duties important at all levels.
- Vertical channels have failed severely at times (Great leap forward). Leaders have learned to rely on alternative sources of information: tolerance of local revolts, whistleblowing (SARS), social media,...

The information problem in China.

- Lorentzen (2013) shows why government investing massive resources in policing tolerates more than 200,000 mass incidents per year. Delivers information from population (that will not protest if too strong repression) and keeps local politicians on their toes.

The taxation problem in China

- This has been solved successfully.
 - Strong state capacity gives high capacity to tax. Chinese state has traditionally set taxes at low level. Standard government expenditures also kept at a relatively low level. Collectivist culture relies more on extended family to provide social insurance. Scandinavian individualist welfare state not a model for China.
 - Significant state ownership gives direct control over state resources, which also helps keep tax rates low and reduces tax distortions (Gordon and Li, 2009)
 - CCP has additional instrument of party mobilization, which can at times mobilize resources. Mobilization and campaigns are a standard instrument of CCP that can be used in exceptional times. Advantage over Western democracies.

How likely is China to democratize?

- Modernization theory (Lipset, 1959) states that income growth should lead to democratization.
- In the 80s and 90s, expectations that political reform would follow economic reforms.
- Deng Xiaoping never supported this view, and initiated repression against wall of democracy (1979) and June 4 movement (1989).
- Fear that slight democratization, like under Gorbachev in USSR, would lead to implosion of power of CCP.

How likely is China to democratize?

- Chinese leaders studied carefully Gorbachev experience and concluded that leading role of CCP should be reinforced.
- Gorodnichenko and Roland (2012) argue that culture can play a role, on top of income, in affecting democratization. Collectivist culture has less propensity to lead to democratization, insisting instead on “good” autocrat, leading to stable and efficient autocracy.

Challenge of international coexistence.

- Existence of democracies is a challenge to CCP power,
- ... but communist China is also a challenge to outside world.
- Other communist regimes collapsed because they were economically inferior to capitalism.
- Capitalism under CCP power must face similar challenge.
- As long as catching up with the West takes place, CCP power should be stable with very high probability. If China starts lagging behind, CCP will face big legitimacy problem. This is the foundation of the fear of low growth. Chinese integration in world economy is necessary to maintain growth and prevent economic “falling behind”. This may still not succeed.

Challenge of international coexistence.

- Belt and Road Initiative (BRI) must be seen in that context.
- Infrastructure investment to help import natural resources to China and facilitate export growth.
- Central Asia particularly important.
- “Maritime silk road” needs naval protection against danger of future blockade (experience of Japan in 1940).

Challenge of international coexistence.

- Chinese international initiatives should not be misunderstood as “expansionist”, but are purely domestically motivated.
- China has no other territorial ambitions than Hong Kong and Taiwan
- CCP power not easily exportable. For that and other reasons, Chinese regime is NOT politically expansionist, despite China’s craving for more economic power.
- Main challenge for the West is to better understand the nature of CCP power, understand its stability as well as its objectives.
- Mistakes can unnecessarily increase international tension:
 - Thinking CCP power can be overthrown through outside political pressure.
 - Misreading China’s international economic initiatives for political expansionism.

Difficulties of coexistence

- Coexistence with stable communist regime in China necessary, but lingering problems.
- China supports globalization and multilateralism, because it has benefited from it, but is unable to become world hegemon because of strong China-centric view of the world.
- National security issues are an impediment in China and in the West to further opening, especially in terms of information and investment flows. Big impediment to Chinese acquisitions abroad and vice-versa.

Conclusions

- Fear that China will become world frontier in innovation is completely misguided. Reduction in innovation gap is to be welcomed, as it was in the past.
- China has no soft power, there is no question of export of “China model”, but is able to use threats and blackmail. These must be resisted whenever illegitimate.
- Differences in political regimes will inevitably continue to create frictions, politically and in terms of foreign investment. Dialogue necessary to reduce frictions.
- Multilateralism is more than ever necessary to have forums (*fora*) for peaceful resolutions of international frictions.