

Snapshot China - Newsletter 2 – 2014: China at the crossroads

By Gilbert Van Kerckhove - 15 August 2014

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Scary and confusing times

Working with China since late 1980 I have lived through many ups and downs. There were times we thought the future looked bleak, the least to say. Three decades later, the country has witnessed a unique progress, transforming a grim Stalinist-looking country into a world power. Today the country is at the crossroads facing the most serious challenges since its opening up in the late seventies. Its leaders confirm our worries by admitting the situation is indeed critical. It is easy to be a pessimist. Quite a number of seasoned expats are leaving, for diverse reasons; I will comment about it in another paper.

I do not pretend to know the future, I have no crystal ball, and anyway the vast majority of so-called economists and analysts end up being wrong, nearly as by tradition.

My intent is to give a quick overview on the complexities when trying to understand China's challenges. Some foreign observers think they have the solution: "China should do this or that and all will be well."

If it were that simple.

Overall, I admit to be worried but I still remain more on the side of the optimists. President Xi Jinping has a lot to deal with. There is hope but the proof will be in the pudding as we say.

China is tightening its already firm grip on social media. Many of the websites we need for our daily work can only be reached through a VPN; the least to say, very annoying. A more free press is a dream far away. As the Party officially opposes "checks and balances", shutting up the media is their normal tactic. It makes it more and more difficult to convince the increasingly cynical citizens.

While the fight against corruption is one of the top priorities, the authorities are out to silence revelations of ... corruption. Seems they want to leave the monopoly to CCDI in investigating flies and tigers; foreigners ought to stay far away and the case of Peter Humphrey is an ominous sign. The party's "Central Commission for Discipline and Inspection" is led by Wang Qishan, the anti-corruption tsar.

In how far is the government serious: is it just a political settlement, a power consolidation? The leaders give a conflicting impression, so we have to wait to see how effective the fight will prove be. In the meantime, the government is adopting draconian measures to shut down any sign of dissent or foreign influence.

It could be rather easy to find cases of corruption and tax evasion. Just check where the new rich got their money, to buy all the luxury cars, to burn money in entertainment venues, and to buy all the real estate. And they love to show it all off. Can they prove where the money comes from? Did they pay their income tax? The massive purchases of real estate in Western countries by Chinese individuals and companies (with official records being easy to obtain): how did the money legally leave China? Again, show the source and income tax receipts.

Then one reads about other countries

So, reasons enough to feel worried.

China has been transformed from a medieval country into a modern and developing power that produced the many cities like Beijing, Shanghai and so much more. Poverty was drastically reduced. I just returned from a trip to Xinjiang, exploring the border regions to Kazakhstan. I was impressed with the tremendous development of cities and the farming land. This being a province that gets lots of negative press.

India is facing starvation, not by the lack of food, but by the effects of poor sanitation. Half of the population, at least some 620 million people, defecate and urinate outside. It exposes the people, especially children, to human waste. As a result, children are in contact with a bacterial

brew that often sickens them, starving them from the inside out, leaving them with mental and physical deficits that will affect them for the rest of their lives. We may not be always happy with Chinese toilets in some areas but visibly this is not an issue in China. One of the many examples of how China managed to change, versus the disappointing development of a country such as India.

The U.S. is being flooded by tens of thousand of children trying to escape the murderous countries they live in, especially Honduras. Children as young as five year are robbed, tortured, killed. Nobody is safe in some Latin American countries, with narco groups and armed gangs terrifying and killing the population. They recruit kids as young as ten years and anybody resisting is killed.

I could go on and list other countries where survival comes first.

Well, should we not be at least a bit happy in China?

The challenges for the new government team

When President Xi Jinping came on board, he faced a pretty grim picture as illustrated in this cartoon. It refers to the over 10,000 dead pigs floating on the river towards Shanghai, but it was also a symbol of the overall situation.



Before handing over, Premier Wen Jiabao said in February 2013:

“Even among top officials, abuse of power, trading power for cash, and collusion between officialdom and commerce continue unabated”

This is what Xi Jinping said in September 2013:

“The President is troubled by what he sees as the country’s moral decline and obsession with money. He believes China is losing its moral compass. He wants the Party to be more tolerant of traditional faiths in the hope these will help fill a vacuum created by the breakneck growth and rush to get rich.”



Winning or losing public support is an issue that concerns the CPC’s survival or extinction.”

XI JINPING
PRESIDENT

One would expect those comments to come from unfriendly foreign media, rather than Chinese leaders. They are well aware of what the issues are, their problem is how to deal with it all when stability remains the overall concern. Just look at the many mass incidents, generated by shady

land deals, pollution, injustice, labor conflicts. And the brutal ethnical conflicts spilling over from remote regions even into the capital.

As a result, concern number one is to maintain stability at all costs and smother any “disturbance”.

So how can President Xi Jinping deal with it?

Previous leaders have never been able to really carry out the needed reforms and to tackle the overall rot of corruption.



The SCMP and Reuters reported on 5 August 2014 (edited):

Xi Jinping told top officials he was disregarding “life, death and reputation” to fight corruption in a terse speech signaling a possible dispute and doubts among party elites over the campaign. Xi was believed to have made the remarks in a closed-door Politburo meeting on June 26.

"We have to take the responsibility since the party and the country had put their fate in our hands. The two armies of corruption and anti-corruption are in confrontation, and are in a stalemate. To fight against corruption, a person's life and death, personal praise or blame, do not matter. Since the future and destiny of the party and the country have been handed to us, we must take on this responsibility."

The campaign launched by Xi against “tigers and flies” (high to low-ranking cadres) when he came to power has seen scores of officials, business associates and their families either jailed, investigated or sacked.

It is obvious that carrying out the needed reforms and cleanup would upset the vested interests at the very top. See here an excerpt from Toxic Capitalism (2012):

China : entrenched interests of the new elite, called the “black collar class,” with their links to the SOEs. The extent of those political-business links was illustrated during the party meetings in March 2012. According to the Hurun Report Research Institute, the seventy wealthiest delegates to China's National People's Congress have personal fortunes together worth an astonishing 566 billion yuan (about \$90 billion!). Compare this to U.S. politicians: America's top 660 power-brokers, the president, his cabinet, the Congress, and the Supreme Court, are together worth a relatively meager \$7.5 billion.

Beijing is not that much different from the political and interest groups, and their lobbying, in the U.S. capital as well as in Brussels. The 2013 Hurun Report:

Members of NPC and CPPCC: 83 are USD billionaires

The annual NPC and CPPCC sessions is the biggest gathering of billionaires anywhere in the world; 31 are NPC deputies with the rest CPPCC delegates, including 10 from Hong Kong

The 2012 list: wealthiest U.S. congressman, Darrell Issa, with a net worth of US\$700 million, would be only the 40th richest member of the NPC.

President Xi has followed a rather astute “power consolidation”. He actually had not much choice if he wanted to tackle the reforms.

First he made sure the PLA was on his side. He became the leader of two new task forces: Central Reform Leading Group and National Security Commission. All clever ways to circumvent the opposition from the NPC, NDRC and other entities housing opposing forces. All while the President sounds politically left but acts economically right.

He started a cleanup of the PLA – much needed as one could wonder: In how far is the PLA “ready” if the chain of promotions and procurement was apparently weakened by corruption?

What is Xi Jinping’s agenda?

See here another extract of my book Toxic Capitalism (edited):

In early 2012 the WB published China 2030, a 468-page report calling for far-reaching economic liberalization, including the break-up of state monopolies in oil, electricity, chemicals, and telecommunications; the full commercialization of the banking sector; and the liberalization of interest rates. It commented that the country's current growth model was unsustainable. The report was backed by Vice President Xi Jinping and Vice Premier Li Keqiang and written by a team from the WB and the Development Research Center of the State Council. As reported in the SCMP and the IHT, the report points at the following six main issues, with some of my comments added:

- Redefine the roles of the state and the private sector, so that China can complete its transition to a market economy; the private sector must be encouraged. (China has more than 10 million SMEs, accounting for more than 95% of the country’s companies. They are responsible for about 80% of national employment and 60% of GDP, according to data from the All-China Federation of Industry and Commerce)
- Enhance innovation and adopt an open society with links to global research and development networks
- Tackle environmental degradation and promote green development
- Tackle rising inequality, ensure equality of opportunity and basic social protection for all
- Strengthen the fiscal system and improve fiscal sustainability. Local governments have been too much depending on land auctions to raise funds. (the need for a more fair taxation system and to combat the grey economy)
- Ensure that China, as an international stakeholder, continues its integration with global markets. (But it will be tough to change China’s attitude...)

In the list, no mention of corruption, but this was already on the agenda as stated by the 18th Party Congress. It seems the President is now tackling the items one by one.

A huge interconnected web of challenges and needed reforms

Mikado or Jenga? all connected - one wrong movement and ...



(pics Wikipedia)

The following list of challenges and issues follows no particular order.

This Newsletter is based in part on talks I deliver to visiting (E)MBA students, in sessions that take easily up to two hours to explain how the items are linked (not always obvious), why they are important, and how the government is trying to address them. I also invite the audience to contribute to or confirm the list.

You could point at some missing items: national debt, RMB exchange rate, ... There is a reason I left them out, but I am sure we can add other valid concerns...

- Corruption
- Environmental issues - increase the use of renewables and non-carbon-based energy
- Let market forces work, balance government & market; more room to the private sector
- Pilot FTZ in Shanghai (and copying it later)
- Reform of the SOE, injection of private capital, check monopolies, contribute 30% in taxes to the treasury
- Streamline the government, reduce bureaucracy
- GDP versus quality of growth - unemployment
- FDI - ODI, finding a new balance
- Industrial reform - Increase added value - overcapacity
- Factory of the World - reshoring, relocation by foreign (and Chinese) companies
- Reduce dependency on exports
- Trade frictions and trade protectionism – in both directions
- Increase consumption (USA 70% of GDP, China 38 to 46%)
- Reduce income inequality
- Education reform - gaokao reform - stimulate innovation - IPR
- Instill civility, morality, and ethics
- Respect for the Constitution - Rule of Law and judicial reform
- Financial reform
- Asset declaration - income tax - capital flight
- Taxation reform
- Real estate registration and tax - national database
- Urbanization - hukou reform - property rights & land reform - 260 m migrants in the cities
- Aging - one child policy - retirement age - labor law
- Local government debt (about US\$ 3 trillion) - local tax reform
- National Basic Social Security Package, reform of social welfare (health, pension, etc.)
- Health sector reform
- Food & Pharmaceutical Security
- Nationalism - patriotism - anti-foreign sentiment
- Territorial conflicts
- Ethnic and religious conflicts
- Foreigners in China (still welcome?) - visa issues