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CHINA'S RISE: Perceptions and Misperceptions

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* This is a version of a presentation made at an ECIPE conference, Brussels, on 4 June 2013.

SOMETIMES IT APPEARS that one has to be Sinophobe or a Sinophile: there appears to be no place for agnosticism about China's rise, or credit earned for attempts at a balanced approach.

Many dire predictions have thus far proved wrong – China is overheating, it is over-cooling, it is facing a middle income trap, manufacturing is slowing, corruption is all-pervasive, investment in fixed assets is too high, consumer demand is down, there is excess capacity in products like steel, real estate is a bubble, there are bad loans everywhere and runaway inflation looms.

China has weaknesses that are all too apparent: domestic red tape, economic institutions are weak and business costs high. The economy is protected by domestic barriers defended by entrenched insider elites, the public sector and state monopolies. Export-driven growth and top-down decision making may not yield good results indefinitely.

Around three thousand Chinese families constitute the apex of politics, economics, social position and connections with the security apparatus. Contacts known as *guanxi* are essential.

China is still a poor country, with about 6% of the population in absolute poverty and its per capita income is around the level where Japan was in 1963. The top 10% own 56% of national income and its Gini coef-

ficient of inequality has touched 0.438, well above the 0.4 United Nations warning level.

Migration from rural to urban life is slowing. The demographic time bomb will explode in the next decade, when 20% of the population will be over 60, and total 300m by 2030. Then there are 200,000 disturbances large and small each year on local issues, unrest due to inflation, centrifugal tendencies in Tibet and Xinjiang, debt-burdened banks and public sector, and over-dependency on exports. There is a non-objective legal system, health standards are poor, there are human rights abuses, and a general trust deficit, especially of the local bureaucracy.

China consumes more energy and emits more greenhouse gas than any other country. Half the most polluted cities in the world are in China. Acid rain from coal burning affects 2/3rds of the country. The natural resource degradation and biodiversity losses are alarming. 40% of the soil is affected by erosion and 10% contaminated by heavy metals. Scarcity and pollution have degraded 75% of the water courses. China seeks to feed 21% of the world's population with only 9% of its cultivable land. Its voracious consumers are pushing up prices, and as the metaphor goes, the Chinese may soon eat everyone else's breakfast, lunch and dinner.

So China has serious, even existential, political and economic transitions and demographic and environ-

mental challenges to overcome. The famous artist Ai Weiwei notes that China is like a runner going very fast but suffering from a heart condition.

China lives in a dangerous neighbourhood, with the US re-balance to the Asia, Japan/China and Japan/Korea tensions, India/China tensions, North Korean unpredictability, and the East and South China Seas territorial disputes. China, Japan and India, the Asian big three, have contrary strategic policies and show no leadership in international organisations. There is no Asian strategic architecture. China has no universal message nor any rules-based vision for Asia. It is as yet ill equipped for the exercise of power politics other than the power of negation already seen in climate change negotiations, the WTO and occasionally in the UN Security Council, never alone but on the coat-tails of Russia.

Given all that, China has risen in the most extraordinary circumstances. It has not fought any major wars, and none on its own territory. It has risen with remarkable speed. It has risen despite lack of international understanding or sympathy. It has had little say in international organisations. It has no cultural or soft-power out-reach, and all its neighbours are wary of it. Those are some of the reasons why its rise is still inscrutable.

CHINA'S TRANSITION AND THE NEW LEADERSHIP

THE POST-18TH CONGRESS leadership wants to keep the growth path on track and places high store on political stability in the short term. Thus domestic policy occupies much more attention than foreign affairs, and the idea of a G-2 with the USA does not attract much interest. The maintenance of the political system is the highest priority, and China sees instability in other countries as a negative example to be avoided.

China has managed the complex transition from the centralised state planned economy to a dynamic one with great competence. It can take complex decisions quickly. It can bring immense domestic resources to bear on clearly defined national goals. The biggest challenge may come in the next few years and these attributes may be needed soon. In the 10 year term of the present Chinese leadership, they may face a crisis like the US financial

storm of 2008 - bad debts and the collapse of a fixed asset in construction bubble, that would rock the whole world. China has been hiding its debt problems, and experts have been warning about a housing bubble. The macro story according to these pundits, is one of bad credit that makes Greece, Spain and USA look like child's play. When it gets to the micro of individual companies, their accounting is terrible, they have negative cash flow and non-collectable receivables.

China's economy is slowing because of reduced exports, slow investment growth, rising labour costs, its strengthening currency, and its manufacturing sector losing some competitive edge. There is mounting local government debt and bad loans in state banks because the economy has become addicted to government controls and state credit. China has been providing liquidity to the world, and if it gets into fiscal difficulties, the global consequences would be unimaginable.

The next 10-15 years will therefore be crucial. China's total debt is around 40-55% of GDP, so China has plenty of room for fiscal stimulus, but the new government does not want to use that method. China will adjust its export-led growth model and increase domestic consumption where they have enough leeway with a high savings rate and foreign exchange reserve, and low budget deficit, public debt, and *per capita* income.

President Xi Jinping and Prime Minister Li Keqiang seem alive to the problems. Xi has been hinting that meritocracy in administration, and avoiding a US type nexus between administration, politics, money, wealth and influence, will be the answer to corruption and also save the Communist Party from decline. China will be a cautious liberaliser. Xi is not a dominant figure in the way that Mao or even Deng was, and will not be able to take big risks. The party does not want another Mao, and the removal of Bo Xilai was a case to illustrate that point. So the great policy lurches that took place under Mao are things of the past. Xi will have to proceed cautiously, keeping the party behind him, because there is resistance to even minor reform within the party itself.

China plans to reduce the state's role in the economy, giving market competition and private business a bigger say in investment and setting prices. Foreign investors will

be allowed into finance, healthcare and other sectors, but no break-up of the huge public sector, or privatising banking, telecom or energy is contemplated. The government plans to loosen foreign exchange controls and liberalise interest rates. In a slimmer role for government, making prices of energy, interest rates and exchange rates more market-driven would improve the economy, encourage private consumption and innovation. A technological upgrade will also be necessary instead of relying on low cost labour. Pro-market bureaucrats are to be inducted, with more delegation of power, and easing burdens on business.

Given a successful handling of the possible financial crisis, China will move with certainty towards great power status with the backing of the people of China for the Communist Party. China has suffered huge and spasmodic upheavals— the Taiping rebellion, the Boxer Uprising, four decades of warlordism, the Great Leap Forward, the Great Famine, the Cultural Revolution and Tiananmen. It is hardly surprising that the Chinese people, despite whatever grievances they harbour, support the stability and predictability of the present system.

China will consume more, import more, innovate more, invest more abroad for technology and brand names, and move into the knowledge economy. Its currency will appreciate to its purchasing power level. China's economic ties with East Asia will bring new prosperity to those countries and create an upwardly mobile middle class and a market for Chinese goods and services. The percentage of intra-East Asian regional trade will exceed the European Union's to become the highest in the world.

CHINA IN THE WORLD

CHINA SAYS IT will work to provide stability in the international financial market and the Eurozone, but would not shoulder the same responsibility as those directly responsible for the crisis. It takes the same attitude towards climate change – namely, common but differentiated responsibility. In a cash-starved and shrinking export environment, the distinction between the givers and takers of liquidity in the world economy has changed, and the belief that the free market is more efficient than regulation and public ownership may have to be revised as well.

A non-English speaking, non-western, non-democratic state will become the world's biggest economy, seeking its own symbols of modernity such as moon landings and bullet trains, projects questionable from a cost-benefit ratio. As yet the world seems unprepared for this dramatic development though it has had plenty of advance notice. For many countries in the world, they could harbour fears of a new type of tributary relationship with dominant China because despite the rapid westernisation of its society, China's approach to politics remains the old school imperial model.

Will China project its own values to reshape the international system? Its rise has been so closely bound to the process of modernisation along western lines that the result may be modernising without westernising, which is less likely, or a western world order without western leadership. Any common Asian vision will depend on China, Japan and India acting together, but they have different and sometimes conflicting and confrontational approaches. So the prospect is of China acting alone and unilaterally, like the USA, but without any formal allies. This does not appear to worry China, and even its 'all weather' friend Pakistan cannot be considered a valuable asset.

Rather predictably, the 18th Chinese Communist Party Congress warned about hegemony, neo interventionism, and power politics, presumably with reference to the USA. It urged China to go out to seek new markets and project an increased international voice without abandoning its proper core interests. Ideological approaches like political idealism and democratic liberalism are considered impractical, and the political organisation of the state has not changed.

The Chinese military is a powerful force. If there was a financial crisis which the party could not handle, the rural areas would see tumult and only the military could step in to save the party, or organise a take-over. But this is hardly a likely scenario as of now. The army sees itself as poorly trained and poorly equipped: hence the emphasis on its modernisation. Attitudes in the military are also probably responsible for the more aggressive assertion of core interests, which it felt was not pursued energetically enough by Hu Jintao.

In foreign affairs, China is practical, goal-oriented, and materially motivated with long term goals. In China it is taken as given that China will be strong, united and recognised as a great power. Xi has adopted the party's dicta, and has tweaked the old Five Principles of Peaceful Coexistence to call for a 'new type of foreign relations'. In introducing respect for core interests into this concept, China seems to want to determine the nature and intensity of bilateral ties and become the final arbiter. We can expect China become more assertive and less deferential. It will strongly resist external intrusion or interference and its rise may challenge the liberal solidarist view of international society.

We can also expect a future China to emphasise non-interference on the lines of Article 2.4 and 2.7 of the UN Charter, to be sceptical of the R2P doctrine, to give up on the Doha Round in favour of greater regionalism, place more emphasis on second and third generation rights, especially the right to development and poverty reduction, and seek reform of international organisations, beginning with the IMF and IBRD, to win more parity. There is no Chinese to be found at the head of any international organisation so far.

China wants a stable periphery - as the 18th Party Congress stated, 'Chinese people are peaceful who fear turmoil'. It sees stability with neighbours as important for development, and the USA as having the biggest potential to support or disrupt its rise. It is not enthusiastic that regional states should strike coalitions with US. It will respond to regionals asserting their interests in China's periphery, but too strong a response will lead to counter-balancing efforts, and so it will try to avoid stimulating threat perceptions among its neighbours. It must delicately balance the need to show its rise is peaceful while underlining its existing sovereignty and territorial claims. China will avoid military confrontation with the USA or even with American allies in the region if there is any fear that the US will intervene.

Domestically, can one party rule co-exist with a private enterprise economy? Is state capitalism possible in post-revolutionary times? The received wisdom is that economic freedom must spill over into political freedom. Once property rights are granted, certain liberalising

tendencies must follow – neither party nor buyer and seller can be above the law, which means courts, lawyers, free speech, association, group interests and political parties. As income and education rise, human rights, property rights and civil liberties should normally follow. Can China defy this historical logic? But the Chinese Communist Party will see economic growth as an endorsement and not as a threat. If China follows the received theory, it will be forced to a new politics, but the result may not be a western model but a Sino-government like Hong Kong or Singapore. The Communist Party shows no sign of relinquishing power; quite the contrary – it recently circulated a warning about western values that were designed to 'westernise and disintegrate'.

The subliminal message in China's actions is that China wants to dominate the world, whether in trade, education, technology, military matters and eventually politics. In Asian issues, the international community already cannot operate without China's support. As for the West, the majority of the world's population cannot be governed by a system designed to benefit the 12%. And a China containment policy will not work. The time has come for the West to treat China as an equal partner.

The Chinese do not help with any clarity; by defining its role and identity in world, by defining modernity with Chinese characteristics, but they have to set their house in order first before any clear formulation emerges. It is hard to avoid the impression that they are still wrestling with the definition of 'core interests' and 'a new type of foreign relations'.

The summit between Obama and Xi this month was a positive step. The more the two countries cooperate, the better the chance of crisis situations not spinning out of control. They should not undercut each other in world issues: they should buck the trend of rising powers clashing militarily with established powers. The rest of the world should not have to choose between two contrasting models. If the USA and China can find a *modus vivendi* the world will be a much safer place for the ensuing decades.

EUROPEAN VIEWS ON CHINA

THE US AND Europe's attitudes to China's rise have been

comparatively benign, facilitating access to WTO and open markets. With the financial problems now besetting the West this openness has become politically more difficult, and China is regarded more as a threat than an opportunity. This view has already caused grave fissures among the EU member states, and may prove short-sighted and counter-productive.

Europe should make its citizens, and especially its business community, more Asia-literate. It should show emerging Asia that it has much to offer in terms of world-class institutions, a skilled work-force, a multi-cultural environment and an open economy ready to transfer technology. It should give space gracefully to emerging Asia in regard to quota and voting rights in the IMF and IBRD - the indebted can no longer be allowed to manage these organisations. It should regard China's rise not only as an economic and commercial opportunity, but as a strategic event. Europe does not have a strategic policy in East Asia and its 'strategic partnerships' with China, Japan, India and South Korea are void of substance. Despite the USA's obvious reluctance to see Europe engaged in geo-political issues in East Asia, the EU should bring some of its vaunted qualities like diplomacy, best practice and persuasion to bear in the region. To appear 'less American' will win credit in Asia and create a space in the strategic theatre, but with Europe in its present disarray, this may be asking for too much too soon. Finally, Europe should stop lecturing China on human rights and good governance, especially when these issues are used as conditionalities. Such tutorials do not have a receptive audience, only prove counter-productive, and sit uncomfortably on a continent that has been responsible for the colonial era that ended only recently.

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