

China Can't Mend Its Economy Without Fixing Its Politics

By the Editors
Bloomberg News

July 15, 2013 – The news that China's gross domestic product grew 7.5 percent from April to June – down from 7.7 percent in the first quarter – has provoked fewer gasps of horror than one might have expected. Chinese officials have been talking down the importance of the number for days. The mainland economy might ultimately grow 7 percent this year instead of at its usual double-digit rate, they've hinted. Nothing to worry about.

These officials, from Prime Minister Li Keqiang on down, are speaking to two audiences: the global financial elite, and the tens of thousands of junior officials who administer Communist rule in China. Top leaders like Li understand that the Chinese economy needs to slow down. Too much money is flowing into unproductive investments – ghost apartment blocks empty of residents, mills churning out steel that no one wants – and local officials, striving to meet high GDP growth targets, are often to blame. By implying that such targets are no longer sacrosanct, Li means to encourage a focus on the quality rather than the quantity of growth.

He's hoping to engineer a "soft landing" for China's jumbo-jet economy, a gliding slowdown in which consumption, not misdirected investment and white-elephant projects, becomes the primary driver

of growth. The effort is laudable and long overdue. Unless Beijing pushes ahead with political as well as market reforms, however, it is doomed to failure.

Mixed Messages

All those officials out in the provinces are receiving mixed messages. For years they've been judged on their ability to meet the official growth targets; not surprisingly, most of them did so. While some falsified figures outright, many others funneled cheap credit to state-owned companies and crony developers. Since the 2008 financial crisis, credit has ballooned to an estimated 173 percent of GDP from 115 percent. This, party leaders have declared, must stop.

Yet local officials continue to be judged by something else – their ability to maintain stability. On any given day there are 500 "mass incidents" in China (an official term, elastically defined). Authorities often try to buy peace with payoffs, or by sanctioning make-work projects to keep protesters employed and quiescent.

Li acknowledges that his reforms will cause pain when projects are canceled and inefficient enterprises shuttered. Yet the government has provided no new means for ordinary Chinese to

vent their grievances – quite the contrary. Thousands of online censors are policing social networks like Sina Weibo more intensely than ever. Efforts to promote greater democracy at the village and county level have stalled. Legal reforms that allowed people some hope of pursuing their claims in court have been slowed and in some cases reversed.

Chinese President Xi Jinping seems to believe that the party can recapture the affection of the masses by intensifying its ideological commitment. Xi has launched a Maoist-style “mass line” campaign to eliminate “formalism, bureaucratism and hedonism and extravagance.” If that fails, local officials can always rely on batons. China spends more on internal security than it does on external defense.

Top leaders show signs of realizing that this can't go on. Li recently encouraged Politburo members to read Alexis de Tocqueville on the French Revolution, notes Minxin Pei, a China scholar at Claremont McKenna College. Faced with mobs at the gates, local officials are only too likely to turn the credit back on, adding to the nearly \$2 trillion in debt that local governments are estimated to have accumulated.

Democratic Discipline

Xi and Li must rebalance their efforts at reform. They have talked about imposing market discipline on lending decisions, by allowing interest rates to rise, for instance. The recent tightening of credit conditions, now partly reversed, was presumably a clumsy attempt to do just that. Broader social

reforms are needed as well. Relaxing household-registration restrictions (hukou) would normalize the position of China's 250 million migrant workers and encourage them to spend more of their savings; former World Bank China director Yukon Huang believes that alone could boost consumption as a share of GDP by 2 to 3 percentage points. A stronger social safety net would also lessen the need to save.

Just as critically, leaders in Beijing need to bolster the discipline of democratic accountability. A freer press would challenge the vested interests that are sure to resist Beijing's newly decreed sobriety. Only empowered and legitimate courts will convince Chinese that their grievances will get a fair hearing.

Ultimately, the vote alone can create a truly effective safety valve for citizens' mounting frustrations. For years Beijing has bought stability with economic progress. Now that the country faces years of painful de-leveraging, its people cannot be expected to meekly accept that the party has their best interests at heart. Even the Study Times, a newspaper run by the Central Party School, warned last week that Xi's mass-line campaign was “not an effective substitute that can realize the function of democracy.”

Western investment analysts have been reassuring their clients that China isn't about to crash, that its leaders retain enough control to oversee much-needed reforms. The truth is, if Xi and Li are to succeed, they will have to surrender some of that control to their people.

—Editors: Nisid Hajari, Clive Crook

Xi Jinping Is Taking the Wrong Lessons From Deng Xiaoping

By the Editors
Bloomberg News

September 3, 2013 – What would Deng Xiaoping make of Charles Xue?

It's a surprisingly edifying question. In the past few weeks, Chinese authorities have been eager to show their allegiance to the rule of law. They have gone after Western pharmaceutical companies for bribery, milk-powder suppliers for price-fixing and a well-known British investigator for illegally obtaining information about Chinese citizens. The most riveting spectacle – the often salacious testimony in the trial of Bo Xilai, a former Politburo member – had hardly ended when reports emerged that the next target might be Bo's mentor, Zhou Yongkang, who would be the highest-ranking party member brought down for corruption since the Cultural Revolution.

That this flurry of activity doesn't reflect merely the workings of blind justice became clear when police rounded up the 60-year-old Xue, a U.S. citizen and one of the most influential online commentators in China. He was charged with "group licentiousness" for allegedly taking part in festivities with multiple prostitutes, like some Chinese Dominique Strauss-Kahn. The arrest came just days after authorities had warned China's top bloggers to watch their step.

The earthy Deng, father of reform-era China, favored a Chinese phrase to describe this kind of legal maneuver: killing a chicken to scare the monkeys.

Deng's heir, Chinese President Xi Jinping, has reason to kill a few chickens right now. At a major Communist Party meeting in November, he and Prime Minister Li Keqiang are expected to introduce a series of potentially far-reaching economic reforms. These are vital if China is to make the transition from its current growth model – in which a flood of artificially cheap money has poured into ghost cities and unneeded factories – to one focused on consumption. Cadres and cronies, who have gotten fabulously rich off the current system, are sure to resist any changes.

The show trials are meant in part to scare these officials, as is Xi's new Maoist-style "mass line" campaign to cleanse the party of "feudalism" and other dire-sounding ills. Officials have been instructed to study an Orwellian "Document No. 9," which blasts ideas such as Western constitutionalism as insidious threats.

Xi may believe he's emulating Deng, who famously refused to relax his grip politically even as he overturned decades of Maoist economic

dogma. A more careful student of Deng might recall that he always intended for political reforms to follow his economic transformation. A true heir would today be working to build independent political institutions and the rule of law. Rather than try to intimidate potential opponents, he would challenge them by allowing citizens and journalists to expose details of their corruption. He would strengthen the judiciary, not exploit it to stage shakily credible trials.

Although he defended the party fiercely, Deng, at least for most of the decade before Tiananmen, also commanded genuine popular support. Chinese were grateful for the prosperity and stability that his reforms produced; they admired him even more for the boldness with which he challenged the vested interests of the day. Their support in turn emboldened him to go further.

No one would argue that the Xi regime enjoys a similar goodwill today. Even if Chinese appreciate their rising fortunes, they are fed up with corruption and in-your-face inequality; dismayed by the devastation of their air, water and food supply; and anxious about jobs and wages. Yes, the party has transformed China into

a global economic powerhouse, just as Deng promised. Unfortunately for Xi, Chinese now want more.

If he were alive, the pragmatic Deng would probably be working hard to make society an ally once again. Xi seems intent on doing the opposite. Xue's arrest has chilled discussion among top Chinese bloggers, who reach tens of millions of people (Xue alone has 12 million followers on the blogging service Sina Weibo). These voices have earned the kind of legitimacy among ordinary Chinese that the regime lost long ago, and would be powerful weapons in the war against vested interests.

The short-term stability Xi is buying inevitably comes at the price of his long-term goals. Xi might worry less about chickens and remember Deng's more famous barnyard quote, the one about how the color of the cat matters less than whether it catches mice. If China's new leaders want their reforms to work, they should be working with, not against, the popular forces that can bring about change.

—Editors: Nisid Hajari, Michael Newman

Bo Xilai Had Too Many Friends and Created Too Many Enemies

By the Editors
Bloomberg News

September 23, 2013 – As a judge sentenced him to life in prison yesterday, a smile spread across Bo Xilai's face. Perhaps he grasped the irony. He'd lost inside the courtroom. At the top levels of China's leadership, though, his methods have won.

Chinese state media have tried to proclaim Bo's conviction as a triumph for the rule of law and a powerful blow in the party's battle against corruption. Editorials have praised President Xi Jinping for his fearlessness. In fact, most Chinese understand that this was a political purge; no more, no less.

Bo's own brutal anti-corruption campaign as party secretary of the inland city of Chongqing – one suspect supposedly died after smashing his head into a prison wall – thoroughly eliminated any potential rivals. But it made him too many friends and too many enemies. His swelling popularity as a corruption-buster irked Xi, while the vested interests Bo had overthrown leapt at the first opportunity for revenge.

Xi's anti-corruption drive differs from Bo's only in the degree of head-smashing. As John Garnaut, author of "The Rise and Fall of the House of Bo," points out, both men eliminated their rivals by going after deputies first, then working their way closer to their intended targets. (Bo's case broke into the

open when his police chief fled to the U.S. consulate in Chengdu and revealed details about the involvement of Bo's wife in the murder of a British businessman.) Both have sought to portray themselves as champions of the people against deep-seated patronage networks.

Another Chinese leader favored a similar strategy when he felt his grip slipping: Mao Zedong. In the 1960s, he initiated vicious campaigns aimed at rooting out potential enemies, using beatings, false confessions and bogus trials. Two of his victims were Xi's father and Bo's father – both of whom were then vice premiers, and both of whom were jailed and tortured.

One might think that Xi would question the virtue of such targeted campaigns, based on the whim of a charismatic leader rather than institutions and impartial rules. Instead he has gone further with a widespread crackdown on Chinese bloggers and other potential critics.

The most positive spin one can put on all this is that Xi is securing his position before rolling out a series of pro-market reforms at the party meeting in November. In Bo, he has taken down a canny rival whose neo-Maoist supporters might have tried to sabotage the reforms. In theory, Xi can now move

with more confidence to reduce the state's role in a dangerously imbalanced Chinese economy.

Nothing about Bo's trial or verdict, however, provides cause for such optimism. If the reforms revealed this fall are to be effective, they will have to cause pain across the state sector, which has grown inefficient and corrupt after years of abnormally cheap financing. Premier Li Keqiang has warned cadres that the experience will feel like slitting their wrists. Targeted purges, no matter how tough, won't get the job done: As long as only certain political families and patronage networks feel the brunt of the

state's wrath, everyone else will simply seek shelter under the protection of the powers-that-be.

Xi and the leadership won't face many more open challengers like Bo. But the rot eating away at the party's legitimacy will continue to spread. This verdict demonstrates that Xi can be ruthless with enemies. It will be worth paying attention if and when China's leader decides to take on his friends.

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Useless Shows of Strength Only Make Japan and China Weaker

By the Editors
Bloomberg News

December 27, 2013 – There is never a good time for Japan's leader to visit the Yasukuni shrine, a controversial memorial to Japan's war dead. For Prime Minister Shinzo Abe to have gone this week is especially inflammatory.

Ever since 14 war criminals were “enshrined” at Yasukuni in 1978, visits by Japanese officials have rightly infuriated Japan's neighbors, who suffered brutal occupation during World War II. That's why Japanese emperors have not set foot in the Tokyo shrine ever since, and why Abe did not go during his first stint as prime minister in 2006-2007 nor since returning to office a year ago. He deserved praise for this restraint, more than he ever received from leaders in Beijing and Seoul.

By visiting the shrine on Dec. 26, however, Abe lost any credit he might otherwise have earned. He did so just as Japan appeared to have regained the moral high ground in northeast Asia – thanks to the equally confrontational behavior of his counterpart in Beijing, Chinese President Xi Jinping.

By unilaterally declaring a wide “air-defense identification zone” across the East China Sea, including over various islands and rocks claimed

by Japan and South Korea, Xi has revived fears of China as a bullying hegemon. Earlier this month, Japan announced an increase in defense spending and a more aggressive defense strategy without eliciting a peep of protest outside of China. Had Japan made its announcement this week, the reaction would be quite different.

What could Abe – or Xi, for that matter – possibly be thinking? An optimist might argue that the two Asian leaders are just being strategic. Both have introduced ambitious and difficult economic restructuring programs; perhaps the theory is that by appeasing hard-liners now, they will forestall opposition on other fronts later. More likely, both men see a more assertive foreign policy as a natural and necessary part of their nations' economic resurgence.

They are wrong: The one threatens the other. Thus far, in both Japan and China, structural reforms are nothing more than talk. The challenges each economy faces today are no smaller than they were at the beginning of 2013. Just in the last few weeks, Chinese leaders have confronted an interbank cash crunch and a major

bankruptcy that have sent tremors through the financial system. Although massive monetary easing has driven down the value of the yen and driven up the profits of Japanese exporters, it hasn't put more money into the pockets of Japanese workers or the tills of stores and restaurants. Confrontation abroad only distracts much-needed energy and attention in both Tokyo and Beijing.

Nor has the aggressive posturing achieved much in geopolitical terms for either country. China's air zone was meant in part to push back against U.S. military dominance in the Pacific. Since its declaration, the U.S. has in fact reinvigorated its "pivot" to Asia. Visiting American officials now find ready audiences and hands outstretched for the tens of millions in U.S. security aid on offer.

Japan has been gratified by the U.S.'s robust response to China's maneuvers. U.S. officials, however, have repeatedly underscored that they expect all sides in the region to work toward lowering tensions and are not pleased with Abe's willful disregard. Relations between Japan and fellow U.S. ally South Korea, which had shown signs of improvement, have now returned to limbo. Chances of coordinated action to deal with an increasingly unpredictable North Korea have crumbled.

Contrary to what Xi and Abe may intend, neither leader is making his nation any stronger with his aggressive posturing. They're only making the region more dangerous for themselves – and for the rest of the world.

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China's Bold Yet Self-Contradictory Blueprint for Change

By the Editors
Bloomberg News

Nov. 17 (Bloomberg) – Call it policy presentation with Chinese characteristics. After the meeting of its leadership last week, China's Communist Party issued a muddled communique that aroused no great excitement. Then, on the weekend, well ahead of the usual schedule for such announcements, the party released a longer follow-up statement worth getting excited about.

It's radical stuff – in principle, if not (yet) in policy. Maybe China's new president, Xi Jinping, aspires to be another Deng Xiaoping after all.

The “Decision on Major Issues Concerning Comprehensively Deepening Reforms” was nothing if not wide-ranging. Tucked inside it were the biggest headlines, so far as many foreign observers are concerned: China's notorious one-child policy is to be softened, and the system of arbitrary confinement to “re- education” in labor camps, a tool of political repression, is to be ended.

Most of the statement, though, is devoted to a comprehensive list of economic and financial reforms. This emphasis is deliberate: “The reform of the economic system is the focus of all the efforts to deepen the all-round reform.” Many of the proposals echo the long-standing

recommendations of pro-market advocates at home and abroad.

The statement calls for China's financial sector to be liberalized. There will be new private banks, as well as further moves toward exchange-rate flexibility, market-determined interest rates and capital-account convertibility. The blueprint calls for price reforms in water, energy, transportation and telecommunications. Farmers will be given new property rights, including the right of succession and the ability to sell shares in their land or use it as collateral. The system of household registration, which controls workers' movement from countryside to city, will be eased (though curbs on migration to the biggest cities will remain).

The document promises far-reaching reform of state-owned enterprises. There'll be more financial disclosure, and managers will be made more accountable. Where possible, it says, such enterprises will be exposed to competition. Mixed forms of public and private ownership will be encouraged. Needless regulation will be dismantled.

There is one caveat, however, and it's a doozy: This “Decision” remains mostly a

statement of intentions rather than a declaration of specific policy changes. And the leadership, by Western standards, is in no great hurry: The plan calls for results by 2020. Putting the ideas into effect will involve every level of government and multiple layers of China's labyrinthine bureaucracy. Liberalization threatens vested interests and will be met with resistance. Good results are by no means guaranteed.

Another reason to withhold judgment is that the party statement undoubtedly envisions a more market-based economy – yet not what one might call a normal country with a normal system of government. Its statement is rife with the contradictions that flow from this.

The Communist Party frowns on what it calls contradictions, and it constantly dedicates itself to eliminating them more boldly – but the anomalies it has in mind are labor disputes, street protests and “emergencies on the Internet.” The jarring tensions between state and liberty, state and market, and one- party rule and democracy are barely noted in the document, much less confronted or resolved.

As a result, even allowing for losses in translation, the statement is full of bizarre disjunctions: “Cultural reform must evolve around the socialist core value system.” On the other hand: “Perfect the market exit mechanism to promote the survival of the fittest.” Karl Marx meets Friedrich Hayek. Perhaps to ensure that these confusing imperatives are responsibly reported: “Institutionalize the government information release system and standardize the vocational qualifications of journalists.” It's both a

radically pro- reform document and proof that the Communist Party still doesn't get it.

The changes to the one-child policy perfectly illustrate the problem: The plan would allow couples in which one parent is an only child to have two children.

The rest of the world may celebrate this as the loosening of an odious infringement of liberty. For the Communist Party, the issue never even arises. It seeks only to fine-tune the rules for demographic purposes: China needs more children – but not too many. (The change is listed alongside another technocratic tweak: “Allow doctors to have a license to work in more than one hospital.”) A step forward for human liberty, no doubt – in a system that still doesn't understand what liberty means.

To an extent that few would have dared to predict, the Chinese Communist Party has maintained its grip on political power even as its economic reforms have unleashed the most astonishing surge of economic growth the world has ever seen. How much longer can that go on? Xi, it seems, is intent on a bold new phase of economic reform, rightly understanding that this is necessary to extend China's miraculous run. But if the “Decision” is any guide, the political reform that China also needs is not yet fit for public discussion.

One day, that subject will have to be broached.

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