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ISSUE BRIEF

Xi Jinping's Politics in Command Economy

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Executive Summary

"All enterprises must persevere in putting proletarian politics in command and ideological and political work first."[1]—Document of the Politburo of the Chinese Communist Party, September 2, 1975

China's leadership has embarked on a new and risky path in economic policy making, one that has huge implications for the Chinese people and for the world. It stands in marked contrast to the emphasis on market opening and engagement with the world that defined the first decades of the post-Mao period that started in 1978. Instead today Beijing is intent on strengthening control over private companies and foreign investment, reserving set shares of its market for indigenously produced technologies like semiconductor chips and electric vehicle batteries, and boosting the role of state-owned firms.

It is all part of what can be considered a new form of state capitalism, defined by a top-down approach to the economy featuring government-directed and supported industrial policies with the goal of creating a far more self-sufficient country, and critically, one that continues to grow rapidly**.** At the same time, it aims to be more egalitarian, overcoming some of the inequalities associated with the earlier approach of growth at all costs while avoiding the social instability that might result from too large a gap. Beijing sees it as providing a new model of growth for developing countries around the world and as directly competing with a Western free market model that China's leaders believe is becoming increasingly broken. In a speech earlier this year to top provincial and national officials, Chinese President Xi Jinping, who is also general secretary of the Chinese Communist Party (CCP), described the rest of the world

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1 Kenneth Lieberthal, James Tong, and Sai-cheung Yeung. *Central Documents and Politburo Politics in China* (Ann Arbor: University of Michigan Press, 1978). doi:10.3998/mpub.20021.

as facing "chaos," and noted with approval China's growing strength saying "time and momentum are on our side."[2]

Following the US-China trade war defined by punishing industrial tariffs pushed by former US President Donald J. Trump, the COVID-19 pandemic that devastated the global economy but which China emerged from relatively unscathed, and in the face of what has become the entrenched policy of Washington to try to block the global expansion of China's technology giants like Huawei, Chinese leaders have become far more open about discussing their ambitious goals. These goals include building a more inward-focused, technologically self-reliant economy, with a larger role for state planning and state firms, and with all businesses, including privately owned ones, firmly under the thumb of the CCP. It includes huge top-down projects like Xi's model modern city of Xiong'an, the "Greater Bay Area," which attempts to link Hong Kong and Macau with Shenzhen and Pearl River Delta cities in a massive integrated economic zone, and other domestic developments that aim to drive faster regional growth in China.[3] At the same time, China aims to continue to expand overseas, through both Xi's signature Belt and Road Initiative (BRI), and by creating its own domestic core technologies that can compete with and displace multinational versions in markets overseas.

Starting in 2020, Xi and his deputies began to refer to their new economic vision as the "dual circulation" strategy, a phrase quickly picked up by cadres across the country and repeated ad nauseum in China's state-controlled press. One "circulation" refers to China's continued engagement with the world through trade and investment as with BRI, while the second is its much expanded internal circulation—relying much more on the innovative abilities of its own people and companies to move up the technology value chain and create China's own globally competitive high-tech products; and relying much more on the spending power of the Chinese people by continuing to expand its middle class outside of big cities and along the coast, and into the smaller towns and rural areas in the interior of China as well.

The new emphasis on what could also be called "politics in command" (*zhengzhi guashuai),* a phrase Mao Zedong regularly wielded, including during the most political of eras, the disastrous 1966-76 Great Proletarian Cultural Revolution, appears to be hurting China's economy, one already beset by challenges. These challenges include a rapidly aging population, excessive reliance on investment and debt, and growing wealth inequality. The challenge facing China's economy is most apparent when looking at productivity which has dropped off dramatically in recent years. The emphasis on top-down planning and the use of multiple targets in the development of technology and elsewhere in the economy has also led to excessive waste of resources and renewed pressure to fudge statistics, a worrying trend that looks likely to skew policy making.

This issue brief will look at the key elements of China's new "politics in command" strategy, including its antecedents in Chinese history originating in the earlier Mao era, and how it was largely abandoned under the Reform and Opening policies pursued by Deng Xiaoping that helped to power the rapid economic growth that defined the 1980s and 1990s. It will examine how the global financial crisis of 2008, during the administration of President Hu Jintao and Premier Wen Jiabao, set in motion a resurgence of state capitalism and a reliance on investment that aimed to keep China's economy growing fast and so avoid widescale layoffs for its workers. And it will look at how industrial policy has now become a defining element of today's economic strategy—and is being taken to new levels—under Xi. The report will examine the strategy's key elements, including the strengthened role of state firms, the increasing encroachment by the party on the operations of private companies, its impact on foreign companies, the use of top-down industrial plans and state subsidies, the central role of Xi in pushing it, and how it has affected policy making among officials in lower levels of government including at the provincial level and below.

A central question is whether the new economic focus will help Beijing succeed in its goal of maintaining rapid economic growth and higher living standards, central to continued popular support for the party, or whether it will hinder or even stall that growth in the face of the substantial domestic challenges of demography, debt, and inequality. (A future report will focus on those same domestic challenges to continued growth and their implications for China's development.)

That outcome will determine whether the party and Xi's administration are able to maintain the still high level of popu-

2 习近平 [Xi Jinping], "把握新发展阶段, 贯彻新发展理念, 构建新发展格局" [Seize the new development stage, implement the new development concept，build the new development blueprint], *求是网* [*QS Theory*], April 30, 2021, http://www.qstheory.cn/dukan/qs/2021-04/30/c_1127390013.htm.

3 Dexter Roberts, *The Myth of Chinese Capitalism: The Worker, the Factory, and the Future of the World* (New York: St. Martin's Press, 2020).

lar support they enjoy today, or whether it is likely to erode, another question that will be examined in this and future reports. Similarly, how Chinese political elites might respond to Xi's unprecedented amassing of power and now clear intention to stay in power for much longer than his predecessors, will also be considered. Finally, this report will provide policy suggestions for other countries and particularly the United States, China's largest trading partner, that aim to slow China's move toward an economic policy defined by "politics in command" and lessen the potential negative impact it will have on their economies and companies.

Background

"The changeover from...capitalist to socialist ownership in private industry and commerce is bound to bring about a tremendous liberation of the productive forces."—Mao Zedong, speech to the Supreme State Conference (January 25, 1956)[4]

For most of the first part of China's modern history, the state exerted ironclad control over the economy with Chairman Mao taking cues from his communist elder, Josef Stalin of the Soviet Union. After the founding of the People's Republic of China in 1949, the custom of five-year plans was adopted, which dictated what would be produced, in what quantities, and where it would be sold and at what price. It was an economy entirely made up of state-owned firms and in the countryside, agricultural communes. Like other communists before him, Mao believed such a "scientific" system would maximize the goods produced and create a much larger and even more vibrant economy. The reality was instead an economy skewed toward developing heavy industries, to the detriment of a strong agricultural or service sector and one which stunted the growth of a consumer market.

That all changed with the death of Mao in 1976 and his eventual replacement with paramount leader Deng Xiaoping. Deng's Reform and Opening policy launched in late 1978 was a clean break with Mao and the past; along with the dissolution of the agricultural communes, the process of reforming and shuttering urban state enterprises began, opening the way for the rise of private enterprise. Deng's most important contribution was to downplay the importance of ideology in the economy. Even as he made it clear that the political system would continue to be tightly controlled by the party, Deng liberated business from politics. As he expressed it in two of his many memorable slogans—China's economy would develop by "crossing the river by feeling the stones"—experimentation rather than through following any dogma; similarly, as Deng pithily put it: "It doesn't matter whether a cat is black or white, as long as it catches mice"—in other words, political orientation wasn't important, getting the job done or, specifically, growing the economy was what mattered.[5]

'Three Represents' Brings Private Business into the Party

In 2002, China's then president Jiang Zemin took a step that was key to the future development of the private sector. Jiang coined a new political slogan, the "Three Represents," as a way to provide ideological justification for a then revolutionary reform: allowing entrepreneurs to formally enter the party. (Earlier in 1999, he had changed the constitution to formally recognize the increasing importance of the private sector.) As with most party catchphrases its meaning was not obvious from its wording. It called for the CCP to always represent "the development trend of China's advanced productive forces, the orientation of China's advanced culture, and the fundamental interests of the overwhelming majority of the Chinese people"—"advanced productive forces" referring to the private sector.[6] After first using the slogan during a study tour of the market-oriented southern province of Guangdong in February 2000, Jiang presided over it being formally put in the party constitution in 2002 and into the state constitution shortly afterward.[7] Those breakthroughs of the 2000s were to usher in a more hands-off approach to the Chinese economy and an ever larger role for private enterprise that was to continue with few setbacks until today's resurgence of state capitalism.

The first hints of this radical shift in economic focus toward a much more government-focused development started appearing as early as 2006, when China announced its Medium- and Long-Term Plan for Science and Technology Development featuring sixteen mainly government-funded megaprojects, including developing a civilian jetliner, manned spaceflights, and nuclear reactors, and began to

4 Mao Tse Tung, "Socialism and Communism," accessed on June 14, 2020, https://www.marxists.org/reference/archive/mao/works/red-book/ch03.htm.

5 William A. Joseph, "Ideology and China's Political Development" in *Politics in China: An Introduction, Third Edition* (New York: Oxford University Press, 2019).

6 Ibid.

7 Ibid.

herald a new strategy it called "indigenous innovation" aiming for domestic tech supremacy in key technologies.[8] In 2009 and 2010, China announced its plans to target twenty separate industries with subsidies and other favorable policies as part of a new Strategic Emerging Industries plan.[9]

The new economic strategy has become much more boldly apparent since Xi Jinping took charge as party general secretary and president in 2012 and 2013, respectively. It doubles down on the earlier plans to achieve homegrown capabilities and today is heavily tinged with what University of California San Diego political economist Barry Naughton has called "technological utopianism."[10] Under Xi, the world has seen the launch in 2015 of another ambitious plan to move up the technology chain and upgrade manufacturing called Made in China 2025; Xi has also made it abundantly clear that the relatively hands-off approach to economic management of previous years is no longer in favor.[11]

The ascension of Xi to a level of leadership power not seen in decades has been critical to the shift now happening in China. Xi, whose character and policy preferences were defined in part by his youthful experience of living and working in the impoverished Chinese countryside, has played a critical part in pushing to reassert the role of the party in business, including that which is privately-run, in downsizing the role and privileges long accorded to foreign companies, and elevating the role of state-owned enterprises once again to a leading role in the economy. Xi's successful changing of the Chinese constitution to allow himself to stay in power indefinitely has given a sense of seeming permanence to the new policies and convinced China's policy makers to take them very seriously.[12]

At the same time, across China, party and government officials appear to be redefining their priorities away from the previous longtime emphasis on constantly trying out new economic reforms in search of policies that would attract new domestic and foreign investors, lift growth in their localities and industries, and often win them promotion in the then GDP growth-oriented cadre measurement system. Today instead they are focusing on the goals and targets handed down under the new industrial policies, aiming to tap the large amounts of readily available government credit, and as they rise to higher positions of leadership in the Chinese system, working increasingly hard to ensure they demonstrate the now apparently mandatory fealty to Xi and his doctrines.

To be sure, China is not alone in pushing new industrial policies and emphasizing a stronger role for the state. The European Union (EU), the United Kingdom, and, notably, the United States, have also all talked about the need to have a much more hands-on approach to managing their own economies. Roosevelt Institute fellow Jennifer Harris and soon-to-become US National Security Advisor Jake Sullivan wrote last year that it was time to "move beyond the prevailing neoliberal economic philosophy of the past 40 years" and to accept that "industrial policy is deeply American."[13] But China arguably is taking it to a whole new level with its sweeping plans for state capitalism. Facing other countries who also are aiming for more self-sufficiency and are jousting to secure key technologies like semiconductor chips has only convinced China to move more quickly toward asserting state control over the economy.

Xi Jinping's Politics in Command Economy

"A great modern socialist country that is prosperous, strong, democratic, culturally advanced, harmonious, and beautiful."[14]

China's new economic experiment is one its leaders see as necessary to meet the challenges it faces internally and those coming from abroad. After decades of an average double-digit annual rise in GDP its economy has started

8 Dexter Roberts and Pete Engardio, "China's Economy: Behind All the Hype," Bloomberg Businessweek, October 22, 2009, https://www.bloomberg.com/news/articles/2009-10-22/chinas-economy-behind-all-the-hype?sref=a9fBmPFG.

9 Ibid.

10 Author interview with Barry Naughton, April 30, 2021.

11 Ibid.

12 Richard McGregor and Jude Blanchette, *After Xi: Future Scenarios for Leadership Succession in Post-Xi Jinping Era, CSIS Freeman Chair in China Studies and the Lowy Institute*, April 22, 2021, https://www.lowyinstitute.org/publications/after-xi.

13 Jennifer Harris and Jake Sullivan, "America Needs a New Economic Philosophy. Foreign Policy Experts Can Help." *Foreign Policy*, February 7, 2020, https://foreignpolicy.com/2020/02/07/america-needs-a-new-economic-philosophy-foreign-policy-experts-can-help/.

14 Xinhua, "Xi Unveils Plan to Make China 'Great Modern Socialist Country' by Mid-21st Century," October 18, 2017, http://english.www.gov.cn/news/top_news/2017/10/18/content_281475912476280.htm.

to slow with quarterly growth between 6.4 percent and 6.9 percent since mid-2015.[15] The reforms that unleashed productivity, including the early move to end agricultural communes and allow farmers to decide what to plant and where to sell it, the rise of rural industry with the creation of township and village enterprises, the market opening driven by China's entry into the World Trade Organization in 2001, the mass migration of people from the countryside to work in factories and on construction sites, state enterprise reform, and the growth of private business all have either run their natural course or with the non-state sector, is now being hindered by political controls.

Its falling birth rate and rapidly aging population—the latest population census shows only 12 million babies were born last year, the lowest number since the famine that followed China's disastrous Great Leap Forward in 1961, and the proportion of those over 65 years of age has grown from 8.9 percent to 13.5 percent over the last ten years—are creating new health care and pension costs which are pressuring families and local governments.[16] The decision in May to allow couples to have three children is not expected to spur significant growth in the population, as it is seen as coming too late.[17] If China does not find a way to move up the economic value chain while keeping growth high it faces the prospect of falling into the so-called middle-income trap, when rising wage costs mean countries are unable to continue to compete in industries built on low-cost labor and do not yet have the technological ability to transition to a higher value-added economy. That would mean China, like Russia, Brazil, and South Africa before it, never graduates into the club of high-income nations.

China's leaders are unwilling to countenance that alarming prospect. Instead, they have set boldly ambitious targets to build China into a much richer and more powerful, globally influential country, tied to both the just-celebrated 100th anniversary of the creation of the Chinese Communist Party (CCP) on July 1 of this year, and the 100th anniversary of the founding of the People's Republic of China coming in 2049. As part of the first of the centennial goals, earlier this year China's leaders already proclaimed success in ending extreme poverty.[18] Two additional targets—doubling GDP and per capita income between 2010 and 2020—were also met and all are part of what Beijing calls "building a moderately prosperous society."[19] The second centennial goal coming mid-century, as well as new plans to once again double GDP by 2035 and start to set global technological standards which Xi announced late last year, are far more ambitious.[20] As the party general secretary explained to assembled delegates in the Great Hall of the People in Beijing at the 19th Party Congress in 2017, the goal is for China to develop into "a great modern socialist country that is prosperous, strong, democratic, culturally advanced, harmonious, and beautiful." The party will not only ensure that "common prosperity for everyone is basically achieved" by 2050, Xi said, but also that "China has become a global leader in terms of composite national strength and international influence."[21]

"We are witnessing major changes never seen in a century, and we need to take the path of indigenous innovation through self-reliance."[22]

Rather than opt for more reform to drive the economic growth needed to meet such ambitious goals—for example, by loosening and eventually ending legacy policies of its past like the household registration system or *hukou,* and dual land policy which restricts the ability of rural Chinese to sell or rent their land at market prices, as well as balance the economic playing field to allow its private sector to

15 Barry Naughton, "Grand Steerage" in *Fateful Decisions: Choices That Will Shape China's Future*, eds. Thomas Fingar and Jean C. Oi (Stanford: Stanford University Press, 2020).

16 Ning Jizhe, "Main Data of the Seventh National Population Census," National Bureau of Statistics of China, May 1, 2021, http://www.stats.gov.cn/english/PressRelease/202105/t20210510_1817185.html; Sui-Lee Wee, "China's 'Long-Term Time Bomb': Falling Births Stunt Population Growth," *New York Times*, May 10, 2021 (updated May 31, 2021), https://www.nytimes.com/2021/05/10/china-census-births-fall.html?smid=tw-share.

17 BBC News, "China allows three children in major policy shift," British Broadcasting Corporation, May 31, 2021, https://www.bbc.com/news/world-asia-china-57303592.

18 Xinhua, "Xi declares 'complete victory' in eradicating absolute poverty in China," Xinhuanet, February 25, 2021, http://www.xinhuanet.com/english/2021-02/25/c_139765861.htm.

19 Xinhua, "Xi Focus: Xi says China can build a moderately prosperous society in all respects on schedule," Xinhuanet, November 13, 2020, http://www.xinhuanet.com/english/2020-11/03/c_139488138.htm.

20 Bloomberg News, "Xi Says Economy Can Double as China Lays Out Ambitious Plans," Bloomberg, November 3, 2020, https://www.bloomberg.com/news/articles/2020-11-03/china-s-xi-says-economy-can-double-in-size-by-2035?sref=a9fBmPFG.

21 Xi Jinping, "Full text of Xi Jinping's report at 19th CPC National Congress," *China Daily*, November 4, 2017, https://www.chinadaily.com.cn/china/19thcpcnationalcongress/2017-11/04/content_34115212.htm.

22 CGTN, "President Xi Jinping calls for self-reliance in Guangdong inspection," October 13, 2020, https://news.cgtn.com/news/2020-10-13/President-Xi-Jinping-calls-for-self-reliance-in-Guangdong-inspection-Uy43r9wWyl/index.html.

grow much faster—Beijing has chosen a very different path. Through massive support of new technologies that have been designated as "fundamental core areas" for national security, its leaders are hoping to both end reliance on the rest of the world and, critically, unleash new productivity on its economy that will enable it to keep growing rapidly for many years to come.

The scale of the plan, which was further fleshed out with the release last November of China's 14th five-year plan, is awesome.[23] In order to achieve breakthroughs in advanced technologies, including artificial intelligence (AI), quantum computing, blockchain, neuroscience, biotechnology, robotics, and semiconductors to ensure its technological self-reliance and power its economy, R&D investment will rise to 7 percent annually and China's leaders intend to spend as much as half a trillion dollars every year, or 4 percent to 6 percent of GDP, according to calculations by Naughton.[24] "It reflects this remarkable confidence or arrogance that they can push the economy in these very major ways that they want to move it," Naughton said in an interview.

Technological utopianism

The plan is based on a belief that the world is at a crucial moment when new technologies and new uses for technology will transform the global economy. As Xi put it in remarks in Guangdong province in 2020: "We are witnessing major changes never seen in a century, and we need to take the path of indigenous innovation through self-reliance."[25] Xi and other Chinese officials believe that countries that get first-mover advantage will dominate not just economically, but will also become the geopolitical and military superpowers of the coming decades. (A key plank of China's grand plan is "civilian-military fusion," or ensuring new technologies not just drive economic growth but also military modernization.) They also believe that technological breakthroughs—likely through AI, cloud computing, and the Internet of Things—have the potential to not just modernize manufacturing but also lead to productivity breakthroughs from new economic and social structures like smart cities. Officials also believe they are well-positioned to dominate new technologies. Among the competitive advantages they identify are having a very large pool of well-educated workers (others see weaknesses in China's aging labor force), the world's largest manufacturing base, as well as an enormous domestic market, all allowing China to leverage scale. "Being the lead market is extremely important, because it means that innovative firms are close to the customer and can adapt and fine-tune innovations to meet customer needs most effectively," writes Naughton.[26]

China for now has the money to fund the plan. After more than a decade of fiscal reforms China's central and local governments have doubled the taxes they take which now amount to more than one-fifth of GDP.[27] And China's officials have access to more funds through both fast-growing social insurance premiums and, notably, the huge revenues earned by local governments through land sales. This larger pool of revenues has grown rapidly in recent years and amounted to 36 percent of GDP in 2018.[28] China's still large state sector, including control over the banks and the interest rates they charge, has also allowed it to engage in what economists call "financial repression"—tapping the high savings of the Chinese people to drive investment, while household consumption is stunted (it still is below 40 percent of GDP, much lower than most other countries around the world).[29] This has allowed China to maintain the world's highest investment rate, around 40 percent of GDP. "Their attitude to this waste is that of the venture capitalist: most of the new firms will fail, and the money spent on them will be lost, but the few that succeed will become future champions," according to Naughton.[30]

"The state advances, the private sector retreats."

A key goal of the new industrial policy is to strengthen the role of state enterprises, often at the expense of the private sector. China, of course, has long stressed the importance of government firms in its economy with their leading role

23 Naughton, "Grand Steerage."

24 Ibid.

25 CGTN, "President Xi Jinping calls for self-reliance in Guangdong inspection," October 13, 2020, https://news.cgtn.com/news/2020-10-13/President-Xi-Jinping-calls-for-self-reliance-in-Guangdong-inspection-Uy43r9wWyI/index.html.

26 Naughton, "Grand Steerage."

27 Ibid.

28 Ibid.

29 Peter Brenan, "Weak Chinese consumption holds back global economic recovery," S&P Global, March 16, 2021, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/weak-chinese-consumption-holds-back-global-economic-recovery-63169784.

30 Naughton, "Grand Steerage."

enshrined in the constitution. But throughout the first few decades of Deng's Reform and Opening policy that emphasis seemed increasingly lip service. As private firms became the key driver of economic growth a popular recent slogan "56789" was coined to describe their importance: they generate 50 percent of total tax revenue, 60 percent of GDP, 70 percent of all innovation produced, and employ 80 percent of urban workers while making up 90 percent of registered companies.[31]

And while the importance of the private sector to China's economy has not lessened, its status in the eyes of China's top officials has undergone a real downgrading in recent years and earlier efforts to make a fairer playing field have stalled. While this trend is abundantly obvious under Xi's government, its origins began much earlier during the global financial crisis of 2008 and spawned the rise of a new phrase *guo jin min tui*—"the state advances, the private sector retreats."[32]

Xi Jinping in charge

In a break with tradition extending back to the Deng era, Xi is the clear power and brains behind the new economic strategy. Having the party general secretary play such an outsized role in setting the terms of and directing the new plan, as Xi is doing, would have been unimaginable under the more collective style of leadership of his predecessors. Economic policies have been the purview of the premier in the past. Much of the strategy's pillars—its emphasis on self-reliance, surprising given how much China's economy and its people's living standards to date can be directly tied to its years of opening to the world; its apparent hostility toward things foreign, including increasingly overseas business; its preference for big state enterprises, even when they are inefficient, over less easily controlled private enterprise; and its focus on a much stronger role for the CCP, not just in politics, but in economics, and indeed in education and society as well—seem linked to the revolutionary ethos of the China Xi grew up in. Coming of age at the height of China's turbulent Cultural Revolution, Xi saw his traditional schooling halted, spent years in the Shaanxi countryside learning, he says, the importance of hard work, frugality, and *zili gengsheng* or self-reliance. Xi, too, is the first Chinese leader to be born after the 1949 revolution and so only knows the rule of the CCP, unlike his predecessors who, at least in their early years, all grew up in a country then ruled by the Nationalist Party.

Xi has been able to push sweeping and disruptive changes across China's economy and society by amassing an unprecedented amount of power, in part through the execution of a far-reaching anti-corruption campaign during his first years as top leader. As well as targeting those who were legitimately venal, at the same time the campaign seems to have crippled any early opposition to his new policies by either removing or frightening into silence all those officials who might have tried to block them. That power later was cemented in place when Xi successfully oversaw the changing of the Chinese constitution to end term limits for the presidency, a move that signaled his intention to stay in power beyond the two five-year terms of his predecessors.

Xi also broke with party precedent by taking charge of several high-level economic policy-making bodies that traditionally would have been led by his number two, Premier Li Keqiang. These "leading small groups" fall under the party and thus function as powerful policy-making bodies separate and superior to the traditional ministries and commissions led by Li in his role as head of the State Council. Of course, Li also is a party member and so could well have headed—and indeed once would have been expected to head—any leading small groups dealing with the economy.[33] Not in Xi's China. Xi not only heads the outward-oriented, small groups that traditionally would be headed by the party secretary general as top leader, such as ones on state security, Taiwan, and foreign affairs, but also is the director of an Internet security committee, a finance and economy committee, and a newly created one, the "comprehensive deepening reform committee," a commanding organization with sprawling responsibilities over military and cultural reforms, along with overseeing all economic reforms.

"Love the motherland, love the people, love the Communist Party."

Another key focus of Xi's has been reining in what had been the increasingly independent private economy. Xi has asserted control over non-state firms in large part by ex-

31 Roberts, *The Myth of Chinese Capitalism*.

32 Dexter Roberts, "China's State Enterprises Have to Pay Up," Bloomberg, May 18, 2012, https://www.bloomberg.com/news/articles/2012-05-17/chinas-state-enterprises-have-to-pay-up?sref=a9fBmPFG.

33 BBC News, "Li Keqiang: China's marginalised premier," British Broadcasting Corporation, September 28, 2020, https://www.bbc.com/news/world-asia-china-19870221.

panding the reach of the CCP over their operations. Former leader Jiang's efforts to bring entrepreneurs into the party with the Three Represents was largely about reassuring them that they would no longer be the targets of anti-capitalist crackdowns and even providing new business opportunities such as opening government contracts to their bidding and allowing them to more easily win business licenses, opportunities that came more easily with party membership. Xi by contrast has sternly reminded private firms of their responsibilities to the party and the nation—not just the opportunities the government provides them. As Xi put it in a key address in Beijing to heads of top private businesses in 2016, China's entrepreneurs shouldn't simply run their businesses with the traditional aim of making money. They must also "love the motherland, love the people, love the Communist Party, and actively practice socialist core values."[34] Just a few days before that Xi had shown just how dramatically attitudes toward private business were shifting. In a speech to the central party school in Beijing,[35] he warned that some Chinese have "unwittingly become trumpeters of Western capitalistic ideology," which could lead to "disastrous consequences."[36]

Not long after those ominous words, Xi launched a campaign to establish party cells in private companies. Starting with some of China's largest and best-known firms, it soon moved to encouraging smaller firms to also participate; according to the CCP's constitution, any firm that has at least three party members can open a formal party organization. Since Xi took power in 2012, the proportion of private enterprises with such cells grew from 35.6 percent to 48.3 percent by 2018, with more than 90 percent for China's largest.[37] And after the announcement of a top-level plan to expand party control in non-state firms last October, the trend is likely to have increased even more quickly (more recent statistics are not available). Ye Qing, vice chairman of the All-China Federation of Industry and Commerce, called at the time for building a "modern private enterprise system with Chinese characteristics," with new party cells exercising control over human resources decisions, carrying out company audits, and monitoring internal corporate behavior.[38] It also is a way to harness them for national policies. "Xi believes Party organizations help mobilize companies to support top-level policy agendas," writes MacroPolo researcher Neil Thomas.[39] "The number of firms that participated in 'national strategies' (*guojia zhanlüe*)—like the Rural Revitalization Strategy and the Belt and Road Initiative—rose from 384 in 2015 to 471 in 2019. Harnessing private sector cooperation makes practical sense for Xi as last year these 500 companies boasted collective assets of 37 trillion yuan ($5.4 trillion)."[40]

A policy called "mixed ownership," where state-owned firms buy into private firms or the reverse, is another way China's government is asserting more control over the private sector. Announced at the Third Plenum of the CCP in 2013 and strongly promoted under Xi, it also aims to make state-owned companies more efficient.[41] One prominent example saw Alibaba and Tencent, best known for its WeChat app, take stakes in state telecom operator China Unicom in 2017, part of an effort to get private firms to invest in state-owned firms operating in the overwhelmingly government-controlled industry of telecoms, as well as energy, rail, and public utilities.[42]

34 Dexter Roberts and Jasmine Zhao, "Chinese Business Feels the Sting of the Party," Bloomberg, May 5, 2016, https://www.bloomberg.com/news/articles/2016-05-05/chinese-business-feels-the-sting-of-the-party?sref=a9fBmPFG.

35 Nectar Gan, "China's President Xi Jinping warns Communist Party schools against 'Western capitalist' values," *South China Morning Post,* May 1, 2016, https://www.scmp.com/news/china/policies-politics/article/1940396/chinas-president-xi-jinping-warns-communist-party.

36 Roberts and Zhao, "Chinese Business Feels."

37 Neil Thomas, "Party Committees in the Private Sector: Rising Presence, Moderate Prevalence," MacroPolo, December 16, 2020, https://macropolo.org/party-committees-private-sector-china/?rp=e.

38 Scott Livingston, *The Chinese Communist Party Targets the Private Sector*, *Center for Strategic and International Studies,* October, 2020, https://www.csis.org/analysis/chinese-communist-party-targets-private-sector; Xinhua News Agency, "中共中央办公厅印发《关于加强新时代民营经济统战工作的意见》" [Announcement from the General Office of the Central Committee of the Chinese Communist Party: Opinion on Strengthening the United Front Work of Private Economy in the New Era],中华人民共和国中央人民政府 [People's Republic of China Central Government], September 15, 2020, http://www.gov.cn/zhengce/2020-09/15/content_5543685.htm.

39 Thomas, "Party Committees."

40 经济部 [Ministry of Economic Affairs], "2020中国民营企业500强发布报告" [2020 Top 500 Chinese Private Companies Publish Report],中华全国工商业联合会 [All-China Federation of Industry and Commerce], September 10, 2020, http://www.acfic.org.cn/zzjg_327/nsjg/jjb/jjbgzhdzt/2020my5bq/2020my5bq_bgbd/202009/t20200904_244200.html.

41 Marshall W. Meyer and Changqi Wu, *Making Ownership Matter: Prospects for China's Mixed Ownership Economy,* Paulson Institute, September 2014, http://www.paulsoninstitute.org/wp-content/uploads/2017/01/PPM_Making-Ownership-Matter_Meyer-and-Wu_English_R.pdf.

42 Cyrus Lee, "Tencent, Baidu, Alibaba take part in China Unicom's mixed-ownership reform," *ZD Net,* August 17, 2017, https://www.zdnet.com/article/tencent-baidu-alibaba-take-part-in-china-unicoms-mixed-ownership-reform/; Meyer and Wu, *Making Ownership Matter.*

That effort has gotten a new boost following a three-year action plan for state enterprise reform that runs from 2020 to 2022 and calls for a deepening of mixed ownership, as does the 2021 to 2025 14th Five-Year Plan.[43] Two national funds pooling private and government funds were set up last year to help achieve these goals. "We will establish a major investment platform to allow more private capital and smaller funds to participate in the SOE ownership reforms," Ma Zhengwu, then chairman of China Chengtong Holdings, the company responsible for one of the funds, said in 2017.[44] Meanwhile, investment moving in the opposite direction, from state firms into private ones, has continued apace: the ninety-six large-scale companies now directly managed by the central government have taken stakes in more than six thousand private companies since 2013, while the number of large private firms involved in mixed ownership went up by 24 percent from 2015 to 2018, according to government data.[45] How much of that progress on mixed ownership reforms is due to arm-twisting by Beijing is a serious question. Private companies have been skeptical about the policy from its beginning. A 2014 survey conducted at the annual Boao Forum for Asia found that 90 percent of private business owners felt they would have no management control even if they were to become board members of mixed-ownership companies.[46]

As George Washington University political scientist Bruce J. Dickson has written,[47] the CCP not only uses "cooptation" to manage its private sector today, but still also uses "repression."[48] Starting in 2015 following an eight-month period where senior managers from thirty-four companies went missing when they were suddenly detained by authorities in connection with investigations, the phrase "lost contact," or *shilian*, became popular as shorthand for the trend.[49] Notable among them was Guo Guangchang, chairman of Fosun Group, a private conglomerate that owned Cirque de Soleil and Club Med, who disappeared for a few days in December 2015.[50] For the few days until he was released without charge, trading in Fosun's Hong Kong-listed shares was halted. More recently, the party has been cracking down on more outspoken entrepreneurs with several put in jail. Real-estate tycoon Ren Zhiqiang, given the nickname "Big Cannon Ren" for his vocal criticism of the party, was sentenced last year to eighteen years in prison for corruption; many believe the fact he wrote an unpublished essay seen as critical of Xi's management of the pandemic was his real transgression.[51] Sun Dawu, who founded an agricultural company in the province of Hebei next to Beijing, was also known for his frank criticisms of the Chinese political system and calls for political reform. A land disagreement with a state company led to him being arrested along with many of his family members in November 2020; later Sun was charged with illegal fundraising and obstructing public service, as well as other offenses, and the government took over his company.[52]

Even those tycoons who don't advocate for political change can get in trouble for having too much power or not showing adequate deference to the government. Concern among Chinese officials had been growing about how e-commerce giant Alibaba's Ant Group was taking business from government-owned banks, with its huge online lending business. After Alibaba's charismatic founder Jack Ma criticized Chinese banks as lacking in innovation

43 Xinhua, "How will China's SOE reform fare with three-year action?" Xinhuanet, January 29, 2021, http://www.xinhuanet.com/english/2021-01/29/c_139707120.htm; Xinhua News Agency, "Proposal of the Central Committee of the Chinese Communist Party on Drawing Up the 14th Five-Year Plan for National Economic and Social Development and Long-Range Objectives for 2030," translated by the Center for Security and Emerging Technology, November 3, 2020, https://cset.georgetown.edu/wp-content/uploads/t0237_5th_Plenum_Proposal_EN-1.pdf.

44 Li Xiang, "Private, State fund planned for SOEs," *China Daily*, September 18, 2017, https://www.chinadaily.com.cn/business/2017-09/18/content_32139300.htm.

45 "Directory," State-owned Assets Supervision and Administration Commission of the State Council, accessed July 6, 2021, http://en.sasac.gov.cn/directory.html; Xinhua, "How will China's SOE reform fare with three-year action?" Xinhuanet, January 29, 2021, http://www.xinhuanet.com/english/2021-01/29/c_139707120.htm; 中华全国工商业联合会 [All-China Federation of Industry and Commerce], "2020 中国民营企业500强 调研分析报告" [2020 Top 500 Chinese Private Companies Survey Report], September 2020, http://www.acfic.org.cn/zzjg_327/nsjg/jjb/jjbgzhdzt/2020my5bq/2020my5bq_bgbd/202009/W020200910356331413523.pdf.

46 Meyer and Wu, *Making Ownership Matter*.

47 Bruce J. Dickson, "The Survival Strategy of the Chinese Communist Party," *Washington Quarterly* 39 (4) (2016): 27-44, https://www.tandfonline.com/doi/abs/10.1080/0163660X.2016.1261563?journalCode=rwaq20.

48 Author interview with Bruce J. Dickson, May 18, 2021.

49 Roberts and Zhao, "Chinese Business Feels."

50 Ibid.

51 John Pomfret, "China's Leader Attacks His Greatest Threat," *Atlantic,* January 25, 2021, https://www.theatlantic.com/international/archive/2021/01/china-xi-jinping-business-entrepreneurs/617777/.

52 Alexandra Stevenson, "China Reveals Charges Against Outspoken Businessman," *New York Times,* April 24, 2021, https://www.nytimes.com/2021/04/24/business/china-sun-dawu-arrest-charges.html?smtyp=cur&smid=tw-nytimesworld.

and behaving like pawnshops in a public speech, Xi and his top regulators had had enough. Ant Group's plans for a $37 billion stock offering in Shanghai and Hong Kong were halted last fall and the usually high profile Ma—previously heralded in the state-owned press for his maverick ways—largely disappeared from public view.[53] Then Alibaba was hit with a $2.8 billion antitrust fine in April, the biggest in China's history.[54] The most recent sign that Ma is unlikely to ever regain his status as one of China's most famous entrepreneurs: when Hupan University, an executive business school in Hangzhou founded by Ma, announced the Alibaba founder is stepping down as its head.[55] And China's state media has attacked the institution as not having the proper licenses to issue degrees. "The government thinks Hupan has the potential to organize China's top entrepreneurs to work towards a common goal set by Jack Ma instead of the Communist Party," a person close to the school told the *Financial Times*.[56] And in early July, just days after ride-hailing company Didi Global listed on the New York Stock Exchange, China's Internet regulator ordered app stores to stop offering Didi's app citing personal data concerns, slamming the company's stock price and dealing what appears a serious blow to its business. Likely in response to the increasingly precarious position of China's entrepreneurs Ant Group CEO Simon Hu, e-commerce company Pinduoduo's founder Colin Huang, and Zhang Yiming, the thirty-eight-year-old founder of ByteDance, the Chinese parent company of TikTok, have all stepped down.[57]

Meanwhile, with Beijing making it very clear that China's top tech companies now have a responsibility to help the state fulfill its development goals, Alibaba, Tencent, and food delivery giant Meituan have announced they will make big investments in cloud computing, autonomous driving, and AI, all of which have been singled out as priority industries in the big plan. "Internet giants with immense data and advanced algorithms should shoulder greater responsibility, aim higher and do more in tech innovation," the *People's Daily* wrote in a December commentary.[58] "The Chinese government expects domestic internet giants to play a bigger role in helping the country achieve tech self-sufficiency," Shen Meng, a director at a Beijing-based boutique investment bank, told Bloomberg.[59] "After all, advancing fundamental technologies require massive capital and manpower. In a country which still lacks a mature venture investment ecosystem, deep-pocketed big tech is in a better position than startups to lead that breakthrough." (Following the crackdown on Ant Group, Tencent also has been told by regulators to put its finance business into a new company where it can be better supervised.)[60]

Goodbye foreign friends

To successfully carry out its ambitious plans to build a much more self-reliant and powerful economy, Beijing needs foreign companies that believe their ability to do business in China is subject to staying in the good graces of the CCP. Sharing technology with local partners should be seen as the accepted price of access to the Chinese market. The feeling of vulnerability of being constantly exposed to possible retaliation from the government and a nationalistic population is being cultivated among all multinationals doing business in China right now. When H&M, Nike, and other brands were pilloried in the state media and online after they expressed concern about sourcing cotton from Xinjiang given reports of forced labor there affecting Muslim Uyghurs, it was just the latest episode where foreign brands have been forced to apologize profusely or accept the possibility of losing access to the Chinese market.

In order to ensure there are no challenges to the official portrayal of the country as powerful and resistant to out-

53 Jing Yang, "Jack Ma, Alibaba's Billionaire Co-Founder, Resurfaces After Months of Lying Low," *Wall Street Journal,* January 20, 2021, https://www.wsj.com/articles/alibabas-jack-ma-resurfaces-after-months-of-laying-low-11611117915.

54 Bloomberg News, "China Fines Alibaba Record $2.8 Billion After Monopoly Probe," Bloomberg, April 9, 2021, https://www.bloomberg.com/news/articles/2021-04-10/china-fines-alibaba-group-2-8-billion-in-monopoly-probe?sref=a9fBmPFG.

55 Sun Yu and Ryan McMorrow, "Jack Ma to step down as president of his elite business school," *Financial Times*, May 23, 2021, https://www.ft.com/content/296d2cce-92ca-438e-aa56-f1c3fc4174f3.

56 Sun Yu and Ryan McMorrow, "Beijing forces elite Jack Ma academy to halt new enrolments," *Financial Times*, April 9, 2021, https://www.ft.com/content/61efaf8b-3bb6-4031-86d8-09274fcf956b.

57 Liza Lin and Yoko Kubota, "TikTok Parent's Founder Zhang Yiming to Step Down as CEO," *Wall Street Journal*, May 20, 2021, https://www.wsj.com/articles/bytedance-founder-zhang-yiming-to-step-down-as-ceo-11621478797?mod=lead_feature_below_a_pos1.

58 *人民日报* [*People's Daily*], "社区团购"争议背后, 是对互联网巨头科技创新的更多期待" [Behind the "Community group purchase" debate, greater expectations for tech innovation from internet giants], December 11, 2020, https://mp.weixin.qq.com/s/apwKrz1JDSVp2514SCMQ3A.

59 Bloomberg News, "China Tech Giants Spend Billions to Fuel Growth After Crackdown," Bloomberg, May 26, 2021, https://www.bloomberg.com/news/articles/2021-05-26/china-tech-giants-spend-billions-to-fuel-growth-after-crackdown?sref=a9fBmPFG.

60 Zhang Yuzhe, Hu Yue, and Luo Meihan, "Exclusive: Tencent Ordered to Set Up Financial Holding Company," *Caixin*, May 26, 2021, https://www.caixinglobal.com/2021-05-26/exclusive-tencent-ordered-to-set-up-financial-holding-company-101718352.html.

side pressure, China's leaders cannot accept criticism of its human rights abuses, its broken promises of autonomy for Hong Kong, or its bellicose approach to Taiwan. "Increasingly [the CCP is] saying you have to choose," former US Deputy National Security Advisor Matt Pottinger said in a speech at the Mansfield Center in Montana in March.[61] "You either have to live by our rules and norms, which means shut your mouths about things like genocide in Xinjiang, or the threat of war with Taiwan, or the undermining of the rule of law and democracy in Hong Kong...or you can forget about having access to the Chinese market."[62]

Now that China doesn't need the help of multinationals as it did before, it is much more willing to take a tough line rather than work hard to woo them, as it did in the years before its entry into the World Trade Organization in 2001, and for almost a decade afterward. Domestic companies now have the financial heft, management skills, and, increasingly, technology that once were only available from overseas. Research by Loren Brandt, an economist at the University of Toronto, found that the number of companies with foreign investment dropped by more than 15 percent from 2013 until 2019, while Chinese firms grew by more than 10 percent.[63] (Data includes all firms with sales of more than twenty million yuan, making up more than 80 percent of industry output.) What we are seeing today is a "comprehensive, top-down economic strategy that aims to reshape the country's economy and its economic interactions with the rest of the world," Brandt said in testimony to the US-China Economic and Security Review Commission on April 15.[64] "This course represents a departure from the main elements of a development path that evolved over the course of the first three decades of reform from 1978-2007," which included "a combination of bottom-up, decentralizing domestic economic reform and external opening," he said.

Challenges

The new economic strategy, not surprisingly, has changed the policy preferences, work styles, and motivations of tens of thousands of local Chinese officials. One key shift has been away from the earlier emphasis common to virtually all provincial, city, township, and village officials, that put lifting local GDP growth as the core priority, argues University of California San Diego political economist Victor Shih.[65] That focus had already slowly started to change over the last more than a dozen years as China's leaders tried to move away from the GDP target-driven economic system that has caused many of the country's most pressing problems. But while the obsession with ever higher GDP directly caused the excessive pollution, destabilizing buildup in local government debt,[66] and the soaring inequality that Beijing now wants to avoid, at the same time it served China well by encouraging competing local officials to advocate for business-friendly policies to attract private and foreign companies prized for their more market-oriented operations, rather than stodgy state-run ones, and thus helped create a far more vibrant, job-creating, productive economy.

Today targets have not vanished, they have just changed. While some of the new aims Beijing pushes are needed for more sustainable growth, such as reducing carbon emissions, or boosting average incomes, others seem to warp economic priorities. Subsidies are showered on localities to help them meet the new technological development goals, including satisfying the often fuzzy concept of producing innovation. In order to measure performance in localities, patent registration has been used as a stand-in for innovation, and so is rewarded with state funds or low-interest loans. "From the standpoint of a local government, they think 'Okay, it is Xi Jinping's world now. We are not being rewarded for experimentation anymore. We might as well be part of this opportunity,'" said economist Naughton.[67]

The fudging of numbers or even their outright falsification has become commonplace. With patents, targets set for raw numbers of filings have encouraged local cadres to expand the number of registrations through various dodges. Tactics have included filing for what are often described as "low quality" patents, whose primary purpose is

61 Matt Pottinger, "Great Power Competition: Beijing vs. the Free World," moderated by Dexter "Tiff" Roberts, Mansfield Center, Facebook video, March 12, 2021, https://pt-br.facebook.com/MansfieldCenter/videos/great-power-competition-beijing-vs-the-free-world/236236971530916/.

62 Dexter Roberts, "The risky logic behind China's economic strategy: 'Politics in command,'" *New Atlanticist*, Atlantic Council, May 7, 2021, https://www.atlanticcouncil.org/blogs/new-atlanticist/the-risky-logic-behind-chinas-economic-strategy-politics-in-command/.

63 Author interview with Loren Brandt, April 20, 2021.

64 *The Chinese Communist Party's Economic Ambitions: Is the Past Prologue?,* US-China Economic and Security Review Commission, April 15, 2021, (statement of Loren Brandt, Noranda Chair Professor of Economics, University of Toronto), https://www.uscc.gov/sites/default/files/2021-04/Loren_Brandt_Testimony.pdf.

65 Author interview with Victor Shih, May 5, 2021.

66 Jean C. Oi, "Future of Central Local Relations" in *Fateful Decisions: Choices That Will Shape China's Future,* eds. Thomas Fingar and Jean C. Oi (Stanford: Stanford University Press, 2020).

67 Author interview with Barry Naughton, April 30, 2021.

to win subsidies rather than break new innovative ground, as well as by splitting what typically would qualify as just one patent into a larger number by individually registering each process under a separate patent, said Brandt.[68] In 2017, China saw a boom in robot makers, which grew to an estimated eight hundred companies in just months, following a new policy that rewarded automation development with tax breaks, subsidies, and cheap land.[69] In reality, the vast majority never made any robots, but instead simply registered to do so to win some of the benefits. In an undistorted market, only a handful would likely survive to become truly competitive, Chai Yueting, director of Tsinghua University's National Engineering Laboratory for E-Commerce Technologies, told the author in 2017.[70]

"East, west, north and south—the party leads them all"[71]

The amount of time that a cadre must spend on studying party ideology and doctrine has skyrocketed, particularly after Xi's sweeping proclamation at the party congress in 2017 that "party, government, the military, society and schools, east, west, north and south—the party leads them all."[72] That year, too, Xi got his own doctrine put into the constitution while still serving as leader, the first time ever that had happened in China. Carrying out ideological campaigns at the local level, often focused on the now official doctrine of "Xi Jinping Thought," can affect an official's promotion, with Chongqing party secretary and Xi acolyte Chen Min'er being one example. (Chen worked under China's top leader in the coastal province of Zhejiang when Xi was party chief there.) "Now everyone in the government knows that if Xi likes you, you're fine. It doesn't matter how well you perform," said Shih.[73]

Having an even larger influence on cadres' performance is Xi's centralization of power and apparently now clear intention to stay on as leader into a third term or for at least fifteen years.[74] This means officials are focused on trying to either win the top leader's favor, or find ways to influence him, sometimes to the detriment of actually carrying out policies. That can work out well when those who lobby him happen to favor a policy that is good for economic growth, but be very bad for China when they support one that isn't. China's heavy focus on promoting AI is probably positive for the economy; the increasing emphasis on the state sector over the private sector which was heavily promoted by China's powerful state planning interests, and which also happened to match with Xi's own preferences, by contrast has become a serious problem for China's economy.[75]

With a single leader holding so much power, there is also the risk inherent in relying on any one person's intellect. This risk is magnified during a crisis. When Xi ends up making what appears now to be the right decision, as he did when he decided to quickly lock down the country in the face of the pandemic saving China from the sickness and death experienced by many other countries and allowing its economy to quickly recover, it is heralded as good leadership. But how would Xi respond to an unplanned military clash with the United States in the Taiwan Strait? In a situation like that, China and the world very possibly could be better served by the more consensus-based style of decision-making that was used before Xi's ascension. That will become an even more serious issue as the leader gets older and could even present China with a succession crisis. "Is Xi akin to Stalin after the purges of the 1930s — a leader who has so thoroughly eliminated rivals and cowed the system that he will remain in power until he can no longer perform the duties of office, leaving a succession battle in his wake?" ask Richard McGregor and Jude Blanchette.[76]

Senior officials under Xi are relatively older than those that served under his predecessor Hu. That is apparent from an examination of CCP Elite, a database that includes some one thousand seven hundred senior government officials in China, and that tracks who they hold allegiance to among

68 Author interview with Loren Brandt, April 20, 2021.

69 Bloomberg News, "Inside China's Plans for World Robot Domination," Bloomberg, April 24, 2017, https://www.bloomberg.com/news/articles/2017-04-24/resistance-is-futile-china-s-conquest-plan-for-robot-industry?sref=a9fBmPFG.

70 Ibid.

71 Nector Gan, "Xi Jinping Thought – the Communist Party's tighter grip on China in 16 characters," *South China Morning Post*, October 25, 2017, https://www.scmp.com/news/china/policies-politics/article/2116836/xi-jinping-thought-communist-partys-tighter-grip-china.

72 Ibid.

73 Author interview with Victor Shih, May 5, 2021.

74 Oi, "Future of."

75 Author interview with Victor Shih, May 5, 2021.

76 McGregor and Blanchette, *After Xi*.

top leaders, compiled by Shih and his colleagues at UC San Diego.[77] Among the senior officials that can be seen as owing their rise to Xi, or as being part of a presumed Xi faction, the average age is about sixty-two years old, or five years older than those who served under Hu at a similar point in each leader's tenure.[78] That also puts them less than five years away from the official retirement age. "Xi is less likely to promote young people and that apparently is because Xi himself wants to rule for life. So he does not want young people around in the government that might challenge him when he is in his 80s. If he instead promotes a person in their 60s or 70s, that person will retire before then," explained Shih.[79] Having a plank of senior leaders that are older than those that came before them could have a bad effect on economic management too. That's because they are less likely to support new reforms and, in addition, are simply less motivated to work hard and try to excel as they near retirement.

"Unprecedented" technological competition, "main battleground" for global power

The lofty ambitions of the plan could end up harming the economy. One of its key aims is to make China self-reliant in technology, a goal Xi talks about incessantly. The focus on relying on one's self is a clear throwback to Mao-era ideology that reached its crescendo during the Cultural Revolution. That was when Xi, like thousands of other youth, was sent to the countryside where he spent years working with farmers and studying the importance of self-reliance and other utopian communist ideals. Now with China's top leaders facing what they view as an increasingly hostile world, one where, for example, the United States has tried to cripple the development of technology champion Huawei, they have decided to make China far more self-reliant across its supply chains. As Xi put it in a speech to top Chinese scientists in May: China must prepare for "unprecedented" technological competition, which has become "the main battleground" for global power, citing AI, semiconductors, life science, quantum technology, and energy as priority areas.[80]

The challenge with these ambitions is twofold. First, previous experience around the world has shown that technological breakthroughs come about through openness and cross-pollination of ideas, not through relying on one's self. Silicon Valley in California with its tech centers from companies from around the world and its multinational engineering workforce, and US universities that attract bright young people from abroad, are perhaps the best examples. China, by contrast, censors the free exchange of ideas in its schools and on the Internet and is unwilling to open its borders to large numbers of immigrants. The Thousand Talents Program has had limited success in luring back even overseas-trained Chinese for long-term appointments, and has faced accusations of espionage from the United States and other countries.[81] Trying to innovate and create globally competitive technologies and businesses while walling oneself off from the world is very likely to fail. At the same time, trying to make everything in one's own supply chain is a tremendous waste of resources, going against basic economic laws like comparative advantage. After a series of failed semiconductor factories, even some of China's officials have gotten worried: companies have "blindly" entered into chip projects and "are exposed to the risk of redundant and low-quality capacity-building," warned a spokesperson from China's National Development and Reform Commission last October.[82]

The vast scale of the plan, which is not only spending billions on developing the latest technologies but also continuing to fund huge national infrastructure projects in areas like high-speed rail, electric car charging stations, and traditional energy projects, is likely to turbocharge the growth of debt, already at a potentially destabilizing high of at least 276 percent of GDP. Given China's still tight control over its banks and financial sector, including capital controls (tightened further with the recent crackdown on the financial business of Ant Group and other tech companies), the risk of financial collapse from excessive debt is low. Instead, the real danger is money continuously funding financially insolvent "zombie companies" and industries, many of which are the state-owned firms favored by Xi. "Zombie businesses

77 CCP Elite, accessed on June 15, 2021, http://chinadatalab.ucsd.edu/elites/.

78 Victor Shih, "Preparing for the Future: Comparing Factional Characteristics of Xi and Hu's Factions in Mid-Tenure," Unpublished work.

79 Author interview with Victor Shih, May 5, 2021.

80 Coco Feng, "Chinese President Xi Jinping seeks to rally country's scientists for 'unprecedented' contest," *South China Morning Post*, May 29, 2021, https://www.scmp.com/news/china/politics/article/3135328/chinese-president-xi-jinping-seeks-rally-countrys-scientists.

81 Anthony Capaccio, "U.S. Faces 'Unprecedented Threat' From China on Tech Takeover," Bloomberg, June 22, 2018, https://www.bloomberg.com/news/articles/2018-06-22/china-s-thousand-talents-called-key-in-seizing-u-s-expertise?sref=a9fBmPFG.

82 Luz Ding, "How China's would-be silicon savior became a debt-ridden disappointment," *SupChina*, October 30, 2020, https://supchina.com/2020/10/30/how-chinas-would-be-silicon-savior-became-a-debt-ridden-disappointment/.

would be sustained by a constant drip-feed of credit, tying up resources and skilled labor. Governments, banks and entrepreneurs have every incentive to collude in this kind of outcome," according to Naughton.[83] Given the high level of support for these bold development efforts, with Xi making clear his preference for huge top-down projects like Xiong'an and BRI, "political logic makes big projects likely to continue and possibly lead to 'zombie infestation,'" writes Naughton.[84]

That prospect would only further hurt productivity, the clearest measure of whether or not China is creating a sustainable, healthy economy. Years of heavy reliance on investment, going back at least to the global financial crisis in 2008 when China launched a $586 billion stimulus package, then the world's largest, has already taken a toll. While accounting for 70 percent of GDP growth before,[85] productivity has fallen to around zero today due to the lack of real reforms plus the growing influence of the state over economic decision making.[86] Meanwhile, the amount of capital needed to increase GDP by one unit has nearly doubled since Xi took power in 2012, according to the Rhodium Group and the Asia Society Policy Institute's China Dashboard.[87] And there are signs that the private sector, although still very important to the economy, is being squeezed. The proportion of manufacturing and infrastructure investment that is made by non-state firms reached a high of more than half of total investments in 2015 and since then has been shrinking.[88]

All of this has huge implications for the world. If China's grand plans succeed and it builds global technological giants, this of course could hurt the business of today's multinationals, including those from the United States. Beijing's already growing pressure on companies, institutions, and individuals to toe its ideological line on Taiwan, Hong Kong, Xinjiang, and Tibet will no doubt become much stronger and effective in muzzling free speech beyond its borders. On the other hand, failure to achieve China's ambitious goals would be equally destabilizing. There is a very real possibility that Beijing's emphasis on politics over business, growing support for its state companies at the expense of private ones, as well as Xi's excessive consolidation of power could backfire. Even if its companies ultimately don't succeed, Beijing's massive financial support to industries will likely create global supply gluts affecting the industries of many other countries. China's decision to focus so much of its policy effort and finance on building a state-led economy rather than on meeting the welfare needs of its own people could cause populist anger—particularly if the leadership's efforts fail. That resentment could flare into real opposition as tensions rise over growing inequality and the challenges posed by a rapidly aging population. A slowing Chinese economy whose management is challenged by growing social tensions would weigh heavily on global growth. The outcome of China's new "politics in command" economy will deeply affect the world. For all these reasons it is imperative that the United States and other countries adopt specific policies to deal with China's deeply ambitious plan for global power.

Policy Recommendations

- The United States should build stronger relationships with allies in Asia and Europe many of which share similar concerns about China's mercantilist trade practices and egregious human rights record. This should also include strengthening the Quad, the economic and security grouping that includes the United States, Japan, Australia, and India, and relations with nontraditional allies like Vietnam, that also shares concerns about China's assertive push into the South China Sea.

- The United States should work to enter the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the successor trade grouping for Pacific nations which former US President Donald J. Trump pulled out of, with the aim of ensuring China's state capitalism does not become tolerated by the grouping; this goal has an added urgency as China has announced in recent months its intention to try to enter CPTPP.

- The United States should earmark billions of dollars of funds for private-public cooperation toward innovating in key sectors, including semiconductor chips. The

83 Naughton, "Grand Steerage."

84 Ibid.

85 Brandt, *The Chinese Communist Party's Economic Ambitions*.

86 Author interview with Loren Brandt, April 20, 2021.

87 "The China Dashboard," Asia Society Policy Institute and Rhodium Group, accessed June 15, 2021, https://chinadashboard.gist.asiasociety.org/china-dashboard/.

88 Lingling Wei, "China's Xi Ramps Up Control of Private Sector. 'We Have No Choice but to Follow the Party.'" *Wall Street Journal*, December 10, 2020, https://www.wsj.com/articles/china-xi-clampdown-private-sector-communist-party-11607612531.

Endless Frontier Act and the Innovation and Competition Act, both now being considered in Congress, are two examples of possible actions.

- The United States should review the Trump administration-imposed restrictive academic visa policies and consider loosening them so that Chinese students can once again return to study in large numbers, many of whom after graduation might opt to work in the United States and contribute to American innovation.

- The US government should work with business groups to support US companies that are under pressure to accede to Chinese censorship. Associations like the American Chamber of Commerce should create special teams within their organizations that focus on finding ways to effectively counter Chinese pressure on US companies, including economic sanctions.

Conclusion

China continues to struggle to transition to a more domestic consumption-driven economy, essential not only for its grand plans to create an economy far less reliant on the world, but also necessary to overcome the growing challenges it faces from falling productivity and excessive reliance on investment and debt. China, too, will face more social pressure as its wealth gap, already one of the highest in the world, continues to grow. Unfinished legacy policies, in particular the household registration and dual land system, plus a deeply unequal education system, present huge challenges to building a larger middle class and more sustainable economy and could also lead to pushback against the CCP, which was founded one hundred years ago and has ruled China continuously since 1949. All these issues will be dealt with in depth in a future report.

A key question to watch in the coming months is how successful China will be in boosting the spending power of its households. Even as China has wowed the world with a dramatically quick turnaround in economic growth, much of it driven by a surge in industrial production—China last year produced one trillion tons of steel, a new global record—incomes and spending, particularly among the middle- and lower-class citizens, have not kept up. Meanwhile, earlier efforts to deleverage have been abandoned at least temporarily, with debt reaching new highs, a trend likely to continue as Beijing persists in its ambitious technology development goals. Key to watch will be whether officials start to downplay their grand plans as it becomes increasingly obvious how they butt up against the longtime goal of economic rebalancing toward a more consumption and services driven economy—or whether officials will double down on them and count on high growth to eventually lift incomes and household spending.

Xi has referred to the "principal contradiction" facing China as "between unbalanced and inadequate development and the people's ever-growing needs for a better life."[89] The trade-offs facing the country as it funds its top-down plans even as it faces ever more pressure to meet social needs will become ever more apparent with new demographic challenges due to its rapidly aging population. The looming demographic time bomb—by 2030 there will only be four people working for every retired person as the labor force starts to drop much more rapidly—means China is in a race against time before the cost of healthcare, pensions, and remaking its economy to deal with a much smaller workforce soars. This is why economist Naughton has referred to China's huge plan as a gamble, "the terms of which will become markedly less favorable in a decade."[90]

China's challenges are quantitatively different from other countries before it because its people are still at a much lower stage of income development. GDP per capita, for example, is at only 27 percent of the United States' and lower than the equally ambitious Soviet Union's was in 1987.[91] Success in this bold gamble will be the only way that China can avoid falling into the middle-income trap. Whether China can create a new economic model, one that is deeply ambitious and costly, far more state-centered, and with a role for private enterprise deeply circumscribed by the party—one that would disprove some of the most commonly accepted development assumptions—is an as of yet unanswered question. Its success or failure will reverberate around the world.

89 Xinhua, "Principal contradiction facing Chinese society has evolved in new era: Xi," *China Daily*, October 18, 2017, https://www.chinadaily.com.cn/china/19thcpcnationalcongress/2017-10/18/content_33401026.htm.

90 Naughton, "Grand Steerage," 64.

91 Andrew G. Walder, "China's National Trajectory" in *Fateful Decisions: Choices That Will Shape China's Future,* eds. Thomas Fingar and Jean C. Oi (Stanford: Stanford University Press, 2020).

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