

LIBERALISM RETREATS IN CHINA

By Charles Grant

Most western governments have welcomed China's peaceful rise and its contribution to global economic growth. In many ways China has become the "responsible global stakeholder" that World Bank President Robert Zoellick once asked for. This year China played a constructive role at the London G20 summit, provided \$50 billion for the IMF and dispatched ships to catch pirates off the Somali coast. Optimists view such behaviour as part of a long-term trend for China to become integrated into the global economy and multilateral governance. The optimists can point to 30 years of economic reform, the steady growth of personal freedom within China and even modest moves towards democracy, with, for example, village elections.

But events over the past year or two must give the optimists pause for thought. Within the Chinese system there is a constant battle between authoritarians and those who are relatively liberal over politics, economics and foreign policy. Neither side has been triumphant, but in the past few years the hard-liners have been winning more of the arguments. Both specific events and long-term trends account for this.

The recent riots in Xinjiang – most of whose victims were Han Chinese – will strengthen the hand of those who believe in a firm grip. Last year's protests in Tibet, the 20th anniversary of the Tiananmen Square bloodshed and the fear that the economic crisis could lead to social instability had already made the party nervous of relaxing its authority.

Notwithstanding recent events, the new strength of the authoritarians has longer-term causes. Several decades of economic success have led China's leaders to believe in the wisdom of their own approach to politics and economics. And although they still repeat the mantra that China is a poor, developing country,

they know that it is becoming a global power, and they are confident enough to flex their muscles from time to time. Some leaders now talk about China's 'inevitable rise'. Meanwhile the financial crisis has – as far as the Chinese are concerned – exposed serious flaws in the western economic system. Worrying that excessive American borrowing will damage the value of their dollar holdings, the Chinese are looking seriously at alternatives to the dollar as a reserve currency. For all these reasons Chinese leaders are becoming less willing to bow to western pressure to change their internal or external policies.¹

¹ This briefing note is based mainly on conversations in China in June 2009. I would like to thank Katinka Barysch, Jonathan Fenby, Bobo Lo, Clara O'Donnell, Simon Tilford, Zha Wen and Philip Whyte for commenting on earlier drafts.

A tighter grip on politics

The political system is becoming more authoritarian. The harassment of dissidents is getting worse. Liu Xiaobo, who led the Charter 08 pro-democracy petition at the end of last year, has been detained since December 2008. Chinese nationals have been banned from working as journalists for western news organisations. Families of earthquake victims who complain about the schools that collapsed are harassed. But at the same time blogger-driven campaigns – so long as they avoid politically sensitive subjects – sometimes shift government policy. The outcry over a young woman who killed a party official who had tried to rape her led to a court freeing the woman. There have been many cases of bloggers exposing corruption by officials or abuses in police stations which have led to the guilty being punished.

Notwithstanding the growing importance of the internet as a medium for reflecting public opinion, the predominant trend is for firmer political control. Wu Bangguo, the influential chairman of the National

People's Congress, told the legislature in March that China wanted neither western-style democracy nor the separation of powers. In the 1990s there had been a movement to make the party and the state more distinct from each other, but that has been reversed. The party is increasing its hold over the judiciary. Some recent senior legal appointments have gone to party officials with no legal training – for example the new president of the Supreme Court, Wang Shengjun. Judges have recently received a directive that they should work to strengthen the Communist Party and only then seek to apply the law.

The party has promulgated a new doctrine known as the 'six whys'. These reflect the new predominance of authoritarian thinking and are intended to guide the ruling elite. They are:

- ★ Why should we uphold the guiding status of Marxism in ideology, in place of pluralistic guiding thoughts;
- ★ Why should we persevere with socialism with Chinese characteristics in place of capitalism;
- ★ Why should we adhere to an economic system based mainly on public ownership, in place of privatisation or 'purer than pure' public ownership;
- ★ Why should we hold fast to the People's Congress system in place of the separation of powers;
- ★ Why should we stick to the system of multiparty co-operation and political consultation under the leadership of the Communist Party of China in place of the multiparty system of the West; and
- ★ Why should we unswervingly persevere in reform and opening-up in place of taking the road back.

Some of the best informed westerners that I met on my recent trip to Beijing think it possible that Wen Jiabao, who heads the government and is generally associated with a more liberal economic and political philosophy, is losing influence to Hu Jintao, the General Secretary of the Communist Party, and other leaders.

The growth of economic nationalism

Even before the economic crisis, the role of the state in the Chinese economy was growing. A recent article in *Foreign Affairs* argues convincingly that market-orientated reform has slowed down since Hu Jintao became party leader and president in 2002. The government has partly reversed price liberalisation and its plans for privatisation. It has encouraged the consolidation of 'strategic' industrial sectors into the hands of a smaller number of state-controlled national champions (these sectors include power, oil, coal, gas, chemicals, telecoms, metals, aerospace, transport, cars, machinery, insurance, grain distribution, railways, aviation, shipping, information technology and armaments). Foreign investors are not welcome in these industries. Indeed, foreign direct investment (FDI) in China has been declining since 2005, partly because the country's leaders have sought to confine FDI to certain sectors where foreigners can provide key technologies (though mayors and regional chiefs are often more enthusiastic about foreign investment)²

² Derek Scissors, 'Deng undone: the cost of halting market reform in China', *Foreign Affairs*, May/June 2009.

These trends have accentuated since the economic crisis hit China. In March 2009 a new anti-monopoly law prevented Coca-Cola buying Huiyuan, a Chinese soft drinks firm – although no reasons were given for the deal being blocked and the law has never been used against a Chinese company. And in July four executives of Rio Tinto working in China – three Chinese and an Australian – were arrested and accused of industrial espionage and bribery. One cannot know what the men may or may not have been guilty of, but foreign businessmen in China thought the timing strange: Rio Tinto had just pulled out of a deal with Chinalco, a state-owned aluminium firm, and talks between Rio Tinto and Chinese steel companies over the price of iron ore had just collapsed without agreement.

The state is also interfering more in trade policy. New rules mean that government procurement contracts linked to the stimulus package must normally be given to Chinese contractors (China is not breaching the WTO code on public procurement because it never fulfilled its promise to sign the code). The government has increased the tariffs that it applies to exports of raw materials like coke, bauxite, zinc and silicon, giving Chinese companies that use these materials an advantage. This has provoked the EU and the US to start a case against China in the WTO. Chinese officials have apparently relaxed their efforts to stamp out the circulation of counterfeit goods. And the government has halted the rise of the renminbi against the dollar, to keep Chinese exports competitive.

The EU's trade deficit with China grew to €170 billion in 2008 (and that of the US to \$270 billion). European Commission officials have calculated that if China opened its markets, EU exports to the country would rise by €20 billion a year. But they report that China shows no signs of removing the most contentious barriers to trade and investment, or doing more to protect intellectual property. The Chinese say that they have no intention of doing what the EU wants, since they know the EU is not going to close its markets to them (officials are not so blunt as to say that directly; academics say it directly). For now, only 0.2 per cent of EU imports from China are currently subject to anti-dumping measures.

Chinese officials and academics express concern about what the EU might do on only one issue: climate change. On this the EU has a united position and is, as far as the Chinese are concerned, very demanding. For now the Chinese are saying they will not agree to binding commitments to stabilise carbon emissions at the Copenhagen climate conference in December. But some of them speculate that if both the US and the EU commit to cutting CO₂ output significantly, China will have to go some way towards quantitative curbs, so as not to be seen as a black sheep. This should not be too difficult for China, since it has adopted quite strict targets on energy efficiency and renewables (for example, 8 per cent of power must be generated from renewable sources other than hydroelectric by 2020), which could be converted into some sort of international promise on carbon emissions. The Chinese will be very demanding in asking for transfers of money and technology to help them meet whatever they sign up to.

A more assertive foreign policy

China is taking a tougher line on several key foreign policy issues. It has stepped up its efforts to protect Burma and Sudan from international criticism. It had no compunction about preventing the UN Security Council from criticising the government of Sri Lanka – a close ally – for its treatment of Tamil civilians during the last phases of that island's civil war. In the South China Sea, where Beijing disputes the sovereignty of many islands with several other countries, China has become more uncompromising. It is upsetting the Indians by repeating its territorial claim to the state of Arunachal Pradesh – and by blocking an Asian Development Bank loan to India on the grounds that some of it would benefit that state.

The Chinese government has abandoned the talks with the Dalai Lama's representatives that had started just before the Olympic Games. It cancelled last November's EU-China summit, to punish France's President Nicolas Sarkozy for the way he handled his meeting with the Dalai Lama. The defence budget consistently grows at a much higher rate than the economy, and China is the only country expanding its strategic nuclear forces significantly. Meanwhile cyber warriors based in China are constantly trying to disrupt and extract information from the computer systems of western governments.

Many Chinese leaders do not appear to see any contradiction between asserting their national interests more forcefully, and accepting that in the modern, inter-dependent world, China can only flourish if it maintains fairly smooth relations with the US and the other major powers. They think China can have it both ways, and for now they are right. But will the Americans and Europeans continue to be so accommodating?

The Chinese are more assertive towards the Europeans than the Americans, because the US is a superpower that has the potential to harm China's interests. For example, the official line in Beijing is that the EU makes much more fuss about human rights in China than the US does. Senior officials and eminent academics who write newspaper columns claim that the EU, worried by its economic decline, is scared by the rise of China. They say the Europeans are using the Dalai Lama and Tibetan separatism to try and dismember this 'scary giant'. The EU's opposition to lifting its arms embargo on China and to awarding the country market economy status is also, they say, about keeping China weak. In fact the US has its own arms embargo on China, and has also refused to grant it market economy status – but people in China are unaware of that, because the government does not highlight the US's unfriendliness.

³ When Hillary had visited China in February 2009 she took a different line: she delighted her hosts by saying that though she would continue to raise human rights issues, they would not be allowed to interfere with discussions on economics, climate change and security. That speech, of course, was widely reported in the Chinese media.

In June 2009, on the 20th anniversary of the Tiananmen Square bloodshed, US Secretary of State Hillary Clinton made a speech saying the Chinese government should come clean and admit the names and numbers of those killed. No European leader would have dared to say that. But almost nobody in China knows she made that speech, because the government decided that it should not be reported. In contrast, whenever anyone in Europe says anything critical about China on Tibet, it is magnified in the state media.³

For many academics and ordinary people, the most important thing about the EU's relationship with China is Sarkozy's meeting with the Dalai Lama in December 2008. When I told researchers at the China Institute for

Contemporary International Relations (a Beijing think-tank) that the majority of European governments did not think human rights should be the most important thing in EU-China relations – and that only the Nordics, Dutch and a few Central Europeans thought that human rights should be central to the relationship – they did not believe me.

For now, relations between China and the US are warm. Barack Obama has continued George W Bush's pragmatic approach to dealing with China. However, a number of subjects could strain this relationship, including climate change, on which Obama will expect China to make commitments at the Copenhagen conference in December; the supposed under-valuation and manipulation of the renminbi, which many Americans believe distorts trade; and Iran.

Obama believes that Iran's nuclear programme, and the risk that Israel will bomb it, is second-to-none as a geopolitical problem. China has already, reluctantly, signed up to three rounds of (weak) UNSC sanctions against Iran. If by the end of the year the current diplomacy has failed to persuade Iran to change the course of its nuclear programme, Obama will ask the world's powers to support very tough sanctions. He will argue that this is the best – and perhaps only – way to forestall an Israeli strike.

Few Chinese people have much interest in Iran, despite the growing commercial ties between the two countries. The Chinese media have devoted little space to the recent unrest in Tehran, while the nuclear programme causes little concern. But Chinese officials understand that Iran is becoming an important geopolitical issue. One senior official who has negotiated with the Iranians told me that he expected new proposals on the nuclear issue from Tehran, once the election excitement had died down. "We have only a short window of opportunity, before things deteriorate," he said. "Without progress on the nuclear issue only two scenarios remain: Israel uses force, which would be a disaster as things could escalate; or more sanctions. We have doubts about sanctions, since they could push Iran to quit the nuclear Non-Proliferation Treaty like North Korea did." Nobody in Beijing wants tougher sanctions but if the West and Russia agree to them, Chinese officials say that they will go part of the way, in order not to create problems in the overall China-US relationship.

Reasons for optimism

Is the tightening of state and party control, and increasing assertiveness overseas, a short-term phenomenon or part of a longer trend? It is impossible to know the answer, but I see two reasons for hoping that the retreat from liberalism may be short lived.

One is that the party has a track record of selecting highly intelligent leaders who are pragmatic enough to overcome difficult problems. These leaders act with great caution and generally avoid risk. When the facts in the real world change, their thinking can evolve.

Take the example of North Korea. Most Chinese officials and think-tankers are genuinely annoyed with North Korea for going ahead with its second nuclear test in May 2009. The Chinese leadership has allowed a public debate on how to handle North Korea. Articles have appeared that criticise the government for having been too soft on Pyongyang in the past. Traditionally, the Chinese have wanted to sustain the North Korean regime, to prevent a reunified and pro-American Korea emerging on China's doorstep. But one official broke a taboo by telling me that a united Korea need not be a problem for China: such a Korea would have to be on good terms with China, its biggest trading partner; and if the US was a threat to China, it was a threat whether or not Korea was unified. One of the most senior foreign policy academics in Beijing told me that if North Korea continued to develop its nuclear weapons and missiles programmes, Japan might pre-emptively attack North Korea, and that if it did China should not complain too much.

The other reason for optimism is that China's continued economic success requires good relations with other powers, some engagement with multilateral institutions and a certain amount of freedom at home. China's leaders may therefore be reluctant to spurn western requests for action on issues like climate change, the exchange rate, Iran or the Doha trade round. They may learn to use multilateral institutions such as the WTO to advance Chinese interests, for example by thwarting protectionism in other countries. They could even try to use the Copenhagen conference and its follow-up to help the Chinese economy become more energy efficient. Europeans taking part in the new Financial Stability Board, which is supposed to guide global co-operation on financial regulation, report that the Chinese participants are professional and constructive (China, like other emerging economies, was never a member of the board's predecessor, the Financial Stability Forum).

The desire of China's 350 million 'netizens' for freedom of expression may constrain the party's authoritarian instincts. This year the government tried to insist that all computers should have 'Green Dam' software installed. The official reason was to prevent people viewing pornography. But the software would also allow the government to stop people reading politically sensitive material on the web. There was an outcry from Chinese internet-users, as well as from overseas (some American firms claimed that Green Dam was based on stolen intellectual property). At the end of June the government backed down, saying that the introduction of the software would be postponed. To draw attention away from this embarrassment, the government then restricted Google's operations in China, on the grounds that they enabled people to access pornography. Many Chinese people think the government was simply trying to help Baidu, Google's Chinese rival.

The blogosphere is much freer than the written press, although sensitive blogs are likely to be deleted (and blogs containing sensitive words cannot be posted at all). "We can write about 70-80 per cent of what we want to write", one blogger told me. But they do not know what they can and cannot write about until they try. Sometimes bloggers find that they can be quite outspoken, for example on policy towards North Korea. In general, politically liberal sentiments are suppressed, but nationalism is permitted. Some bloggers make a name for themselves by adopting a nationalist stance. Rui Chenggang, who now has his own television show, rose to fame by campaigning successfully for the Starbucks cafe to be removed from the Forbidden City, on the grounds that it was an insult to Chinese culture. Thus the internet is not necessarily – from a western point of view – a positive influence on China's development.

Reasons for pessimism

Indeed, one reason to be gloomy about China's future is the impact that nationalism could have on its internal development and relations with other powers.

It is very hard for an outsider to judge the potency of Chinese nationalism, and how deeply – or not – most people feel it. But many of the Chinese people that I asked about nationalism said that it is growing, that the government sometimes manipulates it, and that there are occasions when it influences government policy. For example, the government has not implemented a compromise that it had struck with Japan over gas exploration rights in the East China Sea because of fear of the nationalist reaction. Nationalism also leads the government to be coy about some of its actions: it kept quiet about the \$50 billion that it recently gave to the IMF, because public opinion resents China giving money to western-dominated institutions.

As Martin Jacques points out in his new book, most Chinese people are fervently attached to the unity of the state, and they are not naturally at ease with cultural diversity.⁴ Separatist movements can make them angry. Many Chinese bloggers have criticised the western media for reporting on events in Xinjiang with a supposedly anti-Chinese bias. A lot of Chinese people think the government has been too soft on Tibetan and Uighur separatists. This may influence the way the government handles unrest in those two provinces.

⁴ Martin Jacques, *'When China rules the world: the rise of the Middle Kingdom and the end of the Western world'*, Penguin/Allen Lane, 2009.

The government could have dealt with last year's riots in Tibet or the recent violence in Xinjiang more brutally than it has done. But the clamp-downs in those two provinces are nevertheless likely to sew the seeds of future unrest. Furthermore, the government does not appear to have any kind of political strategy for addressing the social, economic and cultural roots of the trouble. Its approach remains one of homogenisation – making Tibet and Xinjiang like the rest of China – and that may in the long term engender persistent and festering conflicts. Human rights would then move up the agenda in China's relations with the West, creating tensions. Further Uighur protests would certainly create problems between China and the Muslim world, and especially the Turkic countries.

A second reason to be gloomy is that the growing role of the state may do long-term damage to the Chinese economy and also create discord between China and other powers. This argument is not self-evident: the economy has grown rapidly over the past decade, despite the state's huge role. And the \$586 billion stimulus package seems to have revived growth, which could clock up an impressive 8 per cent in 2009. China will, arguably, come out of the recession in better shape than any other country.

⁵ The problem has been current account surpluses and an excess of savings in countries such as China, Japan and Germany, recycled into investments in countries with current account and budget deficits, like the US, the UK and Spain. This recycling kept interest rates low in the deficit countries and allowed asset bubbles to grow.

But China's growth model, overly dependent on exports and an undervalued currency, looks unsustainable. China's leaders (like those of Germany) reject the view of Anglo-Saxon commentators that macro-economic imbalances have been a fundamental cause of the global economic crisis.⁵ Nevertheless the top economic policy-makers and think-tankers do accept that they must rebalance

the Chinese economy, which means boosting consumer demand and services industries, while reducing dependence on exports and investment in big projects. Hence the government's concern to create better social welfare systems, which should encourage people to save less and spend more.

The optimists argue that the Chinese economy is rebalancing. Even before the crisis, a lot of government money was going into the under-developed interior rather than the rich coastal areas, and the stimulus package is similarly focusing on inland China. The central government has made efforts to boost consumption – which rose by about 15 per cent in the first quarter of 2009 – and service industries. A big role for the state is necessary for the next couple of years, say the optimists, after which the private sector will gradually take over as the main generator of growth.

However, the way the economic stimulus package is being implemented may damage the health of the economy. Prompted by political instructions, the state banks are extending credits to big state-owned companies so that they can invest. At this stage very little of the stimulus is being spent on health-care or welfare. Whatever the central government may say, regional chiefs are ensuring that much of the stimulus is going on investment in heavy industry and infrastructure. That is the best way to create jobs in the short term – and it provides many opportunities for corruption. The stimulus will lead to much wasteful investment and in the long run is likely to burden the banks with a lot of bad debts.

If this pessimistic analysis is correct; if the role of the state in the economy, protectionism and hostility to foreign investment continue to grow; and if the party prevents the emergence of an independent judiciary and the rule of law, China will eventually face a number of problems. There will be less competition within China, fewer incentives to innovate and boost productivity, and more misallocations of capital. A diminution of foreign investment will slow down the transfer of new technologies and management skills to China.

A failure to rebalance the economy would also create problems for China's relationship with the West. European governments and EU officials believe that China is becoming more mercantilist, intent on maximising exports and minimising imports. If unemployment continues to rise in Europe, and China continues to resist pressure to open its markets, free traders within the EU – including the Commission – may not be able to resist pressure to apply some reciprocity to the Chinese.

And if China's current account surplus does not diminish significantly, there will be serious tensions with the US and others over exchange rates. The Chinese are trapped by their massive holdings of US government securities: if they start to sell them, the value of their remaining dollar assets will decline dramatically; but if they maintain a big trade surplus with the US, they will have no alternative but to recycle export earnings into US government debt, despite the fact that the value of the dollar is likely to decline.

Can this structural economic imbalance be unwound gradually and calmly, without provoking a geo-economic or geostrategic crisis? Nobody can be sure.

China's ties with the US and the EU depend on much more than economics. If China's political system and its foreign policy continue to become less liberal, its relations with the West will suffer.

Europeans and Americans should worry about who wins the arguments within the Chinese system. Many of the world's most thorny problems, such as illegal migration, climate change, nuclear proliferation and the lack of a deal on the Doha trade round cannot be solved without a co-operative China. If the hard-liners and nationalists triumph in Beijing, the new world order may be neither liberal nor multilateral.



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