



Xi Jinping Won't Enjoy His Third Term

By William H. Overholt

Decades of Western assumptions about the trajectory of China's economic and political development after it began its reform and opening under Deng Xiaoping have gradually unraveled under the leadership of Xi Jinping. Rising challenges threaten China's growth, political stability and foreign policy. That also poses significant challenges for the rest of the world, most notably the United States. William H. Overholt reflects on China's future.

CHINA'S ECONOMIC and political prospects differ sharply from Western conventional wisdom. The most common economic view is that China has demonstrated an exceptional ability to grow, therefore, even if it slows, it certainly will grow faster than the United States and will eventually tower over it. But, as former US Treasury Secretary Lawrence Summers has often pointed out, we Americans tend to exaggerate the present and future prowess of anyone seen as a rival. We did it with the Soviets and we did it with the Japanese. We're doing it again.

ECONOMIC PROSPECTS

The actual prospects for the Chinese economy are quite slow after 2030.

China's rapid growth has been based largely on three drivers: property, infrastructure and urbanization. By the end of this decade, those drivers will be mostly exhausted. The property bubble is popping and is being managed partly by inflating an infrastructure bubble.

Two worsening drags on the economy exacerbate the problem of exhausted drivers. China will continue to need to service the debts that financed the property and infrastructure bubbles. Above all, an aging population is becoming a huge economic burden, one that falls on a declining workforce.

A weakened private sector provides 90 percent of urban employment, 100 percent of net job creation, over half of all exports, and, according to Liu He, 70 percent of innovation. Under Xi Jinping, private-sector investment and credit have drastically declined. While large private companies are taking market share from state enterprises, the private sector as a whole is being squeezed. The big banks cannot do creditworthy lending to local private companies and, under Xi's excessive reform of shadow banking, many institutions that could do such lending have been

targeted. Internet financial companies, such as Jack Ma's Ant Financial, provided a potential solution, but the government feared their control of data and their disintermediation of the banks. So, the government has nationalized the data and assumes the big state banks can use it efficiently; that's unlikely.

Xi Jinping does not seek to curtail the private sector, but he is trying to strengthen the state sector. This forces one to ask whether China will experience Japanification, which is stagnation that results from domination of the economy by a group of large conglomerates in cahoots with a government providing detailed guidance. China's companies are much more competitive and dynamic than Japan's, but, as happened in Japan, Beijing's industrial policies, designed to achieve dominance in every modern industrial sector, are likely to have some very expensive successes and even more expensive failures. Second, as China adopts its own industrial standards different from the West, it risks isolating itself the way Japan isolated its cell phone companies and thereby handed the global market to Apple and Samsung.

Services have exceeded half of the economy since 2015, and their dominance will grow. But the modern services sector — finance, accounting, law, journalism, government and much of education — has been highly protected. Unlike manufacturing, whose efficiency has been hardened by intense international competition, much of the vital service sector remains stodgy, politicized and corrupt. Modern financial and legal systems are vital for entrepreneurship and efficiency. For future Chinese growth this is an opportunity as well as a drag, but, except for a slow financial opening, policy is looking inward. It's a drag.

Chinese growth owes much to governmental and Communist Party entrepreneurship. In early reforms, Beijing deprived local governments of

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adequate fiscal resources but allowed them to start businesses. They gave officials at all levels strict goals but asked few questions about how they achieved those goals. Overnight, town and village enterprises employed 110 million people. Up and down the bureaucracy entrepreneurship flourished. Teachers gave each student half a dozen eggs and taught them how to raise chickens in order to support the school. The Institute of Marxism-Leninism became a consulting firm. Everybody grew, at the cost of universal rule-breaking and corruption.

Xi's crackdown on corruption terminates this era. From the bottom of the bureaucracy to the top, everybody fears being accused of corruption. When there are so many rules, and so many political requirements, any decision makes you vulnerable. In New York City, when the subway workers want to shut the system down in protest, they declare a work-to-rule slowdown. Under Xi, the Chinese bureaucracy has gone from Drexel Burnham with Chinese characteristics to work-to-rule. This affects everything.

Party committees in every company, public and private, have been activated as the ultimate arbiters of strategic business decisions. We don't know how this will work out. Likely the outcomes will be different in different regions and different sectors. We do know that, in many of the large companies in Beijing, the agenda of the party secretary is quite different from the CEO.

Across China, this rule may mean a little sand in the gears or a lot of sand in the gears, but it is sand in the gears.

Finally, foreign investors are going to be far more careful about what and how much they put in China. Foreign direct investment has proved vital to China's economic success. When China joined the World Trade Organization, its superior openness to foreign automobile companies — unimaginable in Japan and South Korea — saved the American car industry. Foreign businesses rushed to China, and they defended China against protectionist attacks. But now, if Huawei or the battery manufacturer CATL is given full access to the US and European markets, while foreigners are held to a small share of the Chinese market, the Chinese giants will utterly destroy their foreign competition — not through superior business acumen but through unfair access. Quite aside from Western national security actions, the resulting determination of foreign businesses to diversify their supply chains will have some negative effect on Chinese growth.

China will have economic wins. It is the world leader in every form of green energy and its success in reducing the carbon content of its energy use contrasts sharply with America's pathetic record. China will set the standard for good trains and, given US protectionism, the US will continue to have no Asia-class trains. China's space program is world class. Beijing's focus on

digitization and artificial intelligence in industry will generate some gains. But the overall Chinese future will be slow growth.

Aside from overall growth, China is also experiencing an unsettling budget transition. At the turn of the century, gross domestic product (GDP) was growing very fast and government revenues were growing twice as fast. The Chinese economy was monetizing, and tax collection was improving. Extraordinary revenue growth created a bull-market mentality. When Xi first took power, it seemed the Chinese government could do anything and everything — eliminate poverty, fund social services for an aging population, build the world's greatest infrastructure, grow a military to compete with the US, commit a trillion dollars or more to the Belt and Road Initiative, buy the world's great ports and great technology companies. Now economic growth has halved, and revenue growth must converge with GDP growth. The difficult transition from bull-market mentality to sobriety hit hard in 2022.

IS XI ALL-POWERFUL?

This sobriety coincides with a new politics. Conventional wisdom holds that Xi is China's most powerful leader since Mao Zedong and can do just about anything. That's nonsense. I'll begin with the context.

Leaders' greatest task throughout modern Chinese history has been to create stability out of chaos. Mao unified the country, and Chinese opinion reveres him for that despite privation, starvation and millions of deaths during his rule. Into the 1990s, though, Beijing still confronted basic challenges of stability and unity. During that decade, the government first became capable of vital government functions like controlling the money supply, suppressing inflation, replacing provincial leaders as needed and reassigning regional military commanders. These achieve-

ments succeeded in fulfilling one of world history's most difficult tasks.

However, the early 21st century brought retrogression. Under Hu Jintao (2003-2012), ministers often defied the prime minister, and private-sector leaders often derided the prime minister's edicts. Local leaders flouted central government directives. Spectacular corruption undermined Communist Party legitimacy. Private companies dominated growth, new employment and innovation, and some were becoming politically assertive. Demonstrations rose by an order of magnitude. Marxism was becoming just a boring required class in school. Party membership was largely opportunistic. Vice ministers returned from Harvard and Oxford with contaminated thoughts. Reform dynamism vanished. The Communist Party leadership seemed to the leaders of the party to be at risk. Faced with this, Hu vacillated.

This backsliding reflected a weak party leader and a corrupt prime minister's family, but more fundamentally, Chinese society had passed a threshold of social complexity. Economic success turned a simple economy into a complex one, and each segment had education, resources, organizational skills, political interests and expanding cosmopolitan connections with the outside world. This was the point in social development when China's developmental dictatorship predecessors in South Korea and Taiwan had acknowledged social changes and accommodated it with more market-oriented economics and more market-driven politics.

Xi's mandate was to resolve the crisis of complexity: ensure order, restore central control, reignite economic reform and save the party. This immense assignment seemed disproportionate to Xi's limited domestic political base, which peers expected to render him controllable. But Xi did not vacillate. Rather than accommodat-

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ing complexity, he fought it. Corruption had to be conquered, potential challengers routed, civil society atomized, the government and economy centralized, party control rendered absolute, Marxism reimposed, regrettable history erased, nationalism inflamed and foreign ideas filtered.

The threat was omnipresent: corruption was everywhere, civil society and cosmopolitan ideas were everywhere, personal vulnerabilities grew raw. So Xi sought personal control of everything. His multiple titles put him in charge of the party, the government, the military and eight powerful "Leading Small Groups" that manage everything from "comprehensive deepening of reform" to economic and financial management, internet security and informatization, military reform and national security co-ordination. With remarkable efficacy, he banished all potential challengers. He broke established norms such as the two-term limit and the requirement to groom successors. He wrote himself into China's constitution.

Numerous titles and banished opposition do not, however, provide evidence of confident, absolute power. Xi is accountable to the Communist Party, whereas Vladimir Putin's party is an entourage supporting his accumulation of power and wealth. For another perspective, imagine a CEO of a US conglomerate who appoints himself managing director of every important business unit; he would be perceived as insecure and unskilled at delegation. In contrast, pre-eminent

leader Deng Xiaoping could have destroyed his ideological opponent, Deng Liqun, and his market reform opponent, Chen Yun, but he had the confidence and wisdom not to do so. Indeed, Deng's leadership team (the "Eight Immortals") comprised immensely powerful figures with conflicting ideas and momentous power scheming. Likewise, China's success under Jiang Zemin resulted from Jiang's wise balancing of personalities as different as reformist Zhu Rongji and conservative Li Peng. The most confident leader of modern Chinese history was Deng Xiaoping in his later years, leading China with one title: Honorary Chairman of the Chinese Bridge Players Society.

To assert central, and specifically party, authority, to attack corruption and to acquire the clout to impose his will on the economy, Xi took on every elite group at once. The anti-corruption campaign jailed more than 100,000 officials of the party, the government, the military and business, including top generals and the Politburo Standing Committee member managing security. State enterprise leaders lost half their compensation. Private-sector credit and investment collapsed. Giant conglomerates disintegrated. Tech sector executives and investors lost US\$2 trillion in the recent regulatory crackdown. Clean-energy leaders personally lost US\$140 billion. Provincial and local leaders have found their jurisdictions financially squeezed and their personal incomes slashed. Simultaneously they lost

their innovative freedom of action. Central and local officials, formerly notable for their innovative energy, are demoralized, fearful and immobilized. Wealthy and middle-class parents seek to get their money and children out of the country, forcing Xi to enhance capital controls and restrict officials from having family and property abroad. The crackdown on companies hurt the bankers and Xi's reforms decimated the enormously important shadow banking sector. To demolish any potential civil society resistance, Xi has repressed teachers, tutors, lawyers, journalists, feminists, homosexuals, Christians, Muslims, Falun Gong and NGOs. Many enemies.

Xi's anti-corruption campaign is enormously popular with the masses. Likewise, his assertion of Chinese global leadership and his blaming of problems on America was as seductive in China as Trump's similar blaming of Muslims and Mexicans was popular in the US. Cracking down on what he saw as the spoiled, pampered people of Hong Kong and the separatist terrorists of Xinjiang also garnered mass support. The elite honors Xi for saving the Communist Party but is very skeptical about his retrograde economics and politics.

Xi's political strategy contrasts with Turkey's founding leader, Kemal Ataturk, who, facing many groups that needed reform, sequentially amassed powerful coalitions, then confronted resistant groups one at a time. Xi has a devoted mass base comprising the overwhelming majority of the population, but alienating so much of the elite is risky, and the mass base could start to dissolve as the economy weakens. The Zero Covid protests shatter the image of invincibility and foreshadow future problems.

KEEPING IT GOING WON'T BE EASY

Xi's control of propaganda, the security apparatus, the party, and economic management ensure that he can maintain mass support and, for now,

suppress overt manifestations of elite discontent. He will almost certainly be able to maintain this stability through his third term. Nonetheless, his policies and power are at risk.

Successful pushback limits further crackdown on internet platforms. The umbrella phrase for his social goals, "Common Prosperity," barely made it into important recent policy documents. The Belt and Road Initiative is downplayed. Propaganda organs intensely spread pro-Russian propaganda, but from May, the majority of WeChat users have been pro-Ukraine. Xi spent so much of his first decade as leader consolidating power that he had to rush for important accomplishments in year 10. But year 10 has not been a good year.

Xi's protectionism deprived Chinese of access to effective Covid-19 vaccines and necessitated lockdowns of hundreds of millions of people. With the lockdowns and bursting property bubble, the once-triumphant mood in China changed drastically. For years, consensus opinion held that China was rising, the US declining and that the superior wisdom of technocratic Chinese leaders ensured constant success. The atmosphere resembled the earlier American triumphalism of George W. Bush and Dick Cheney — until financial crisis and failing wars imposed American sobriety. Something like the resultant sobriety has now descended on China.

China's 2013 excitement over a new era of reform, when the market was going to be the primary determinant of the economy, political unity was going to be reinvigorated, and corruption was going to be banished, became the grim doubling down on Covid policy, Russia policy, infrastructure overinvestment and propping up the housing market by inflating the infrastructure bubble.

Xi's signature foreign policy, the Belt and Road, now has a gastric band. Xi's signature domestic goal of Common Prosperity would require a property tax, an inheritance tax, highly progres-

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sive income taxes, and abandonment of hukou controls on internal migration, but resistance is intense. The country has been trying unsuccessfully for 11 years to experiment with a desperately needed property tax. Common Prosperity may be stuck with campaign symbolism (decapitating the wealthy leadership of major private companies, extracting large charitable contributions, nationalizing their data and hampering their stock market listings) rather than actually reducing inequality.

Notwithstanding a fierce campaign against corruption, Xi's hierarchical polity and more statist economy will nurture corruption as a wet log nurtures mushrooms.

New policies must pass through layers of officials resentful of reduced pay and authority and fearful of taking initiative. Xi will not be a lame duck, but he will be a slow duck.

While all Chinese leaders want China to be a rich and powerful global leader, Xi's domestic and foreign policies are not the inexorable culmination of a decades-long Chinese strategy. Quite the opposite. His Hong Kong and Xinjiang policies are a sharp break from his reform-era predecessors. His economic policies reverse key predecessors' moves promoting openness, market orientation and diverse competition.

Each post-1949 Chinese leader has remedied his predecessor's errors. Xi's overruling of the decennial change of generations hampers that

adaptability but does not eliminate the possibility of change. Because Xi's core political policies seek to push back the tides of social diversity, repression must either relax or worsen, not remain constant, a choice that could divide China's elite. Change could occur. So could a mammoth succession struggle. Western leaders need to be prepared for sharply different future Chinas rather than ossifying today's relationship.

While one can confidently predict the slowing of China's growth, a slower China does not ensure superior US growth; that would require US stability and competent management.

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