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China's Xi Factor

HONG KONG – Before China's leadership transition earlier this year, experts said that the Chinese Communist Party was intent on preventing a larger-than-life personality from assuming power. The CCP, it was argued, wanted someone more like the bureaucratic outgoing leader, Hu Jintao, rather than a charismatic successor like, say, the former Chongqing provincial governor Bo Xilai.

Yet the new president and CCP leader, Xi Jinping, is hardly dull. He began his term by paying homage to Deng Xiaoping at his statue in Shenzhen, where, more than three decades ago, the former Communist Party leader had launched the campaign to convert a reluctant Party to free-market reforms. In a top-level November meeting, Xi set out the details of a fundamental change in economic direction, overshadowing his colleagues.

Xi now leads a new economic group that will coordinate and impose his reforms on fractious colleagues. And, unlike Hu, he immediately became head of the military and now runs a parallel national security council. At first glance, a new "paramount leader" appears to be emerging.

Recent history explains this re-concentration of power. In 1993, central-government leaders enjoyed relatively limited powers: they did not control the money supply and had difficulty firing provincial governors or relocating top generals. Central

government revenue was low; indeed, proportionately smaller than that of central governments in any other major economy.

This changed when then-Party leader Jiang Zemin and his prime minister, Zhu Rongji, centralized authority in order to stave off economic crisis at a time of growing risk to China's banks. In the process, the labor force of China's state enterprises declined by 50 million, China lost 25 million manufacturing jobs, and central-government employment was slashed. These measures saved China's economy, but at the price of widespread social stress, which made Zhu widely disliked when he left office.

Popular reaction against the cosmopolitan, coastal, and market-oriented reforms of Zhu and Jiang brought to power leaders whose formative experiences were in the inland provinces of Gansu and Tibet. Riding a wave of resentment against inequality and social tensions, Hu and his prime minister, Wen Jiabao, promised a "harmonious society," without the stresses of Zhu's agenda. They slowed economic reform and ceased political reforms. The bureaucracy expanded from 40 million to 70 million, and power devolved to provinces, bureaucracies, and state-owned enterprises (SOEs).

The somnolent Hu/Wen era, fortunately, did not dampen the economic growth triggered by the earlier reforms undertaken by Jiang and Zhu. But the economic-growth model that those reforms created was running out of steam. Low-cost exports were struggling as labor costs rose. Investment in infrastructure was shifting from growth-enhancing projects, such as inter-city highways, to less productive shopping malls in second- and third-tier cities. Productivity plummeted in SOEs, whose privileged access to financing crowded out private-sector investment. Local-government funding, through the seizure and resale of property, was reaching its limits.

Thus, it became essential to launch a new wave of far-reaching reforms, including liberalization of interest rates, securities markets, and foreign-exchange controls, in order to fund the more productive private sector and reduce excess capacity in SOEs. In particular, the reforms were needed to deflate an emerging property bubble resulting from huge savings and foreign capital inflows that had no other profitable investment outlet.

The government planned to liberalize interest rates and the capital account to encourage investment in modern, high-value industries, rather than continue to subsidize low-value exports. It started to shift the economy's base from export-oriented industries to domestic growth, and from manufacturing to services. And it announced

its intention to slow local governments' seizures of farmland and excessive borrowing through captive enterprises.

Unsurprisingly, opposition to reform was implacable. SOEs were determined to defend their privileges. Highly leveraged local governments could not tolerate higher interest rates or an appreciating currency, and they were adamant about continuing land sales and opposing property taxes. They feared the financial burden of new requirements to provide social services to urban migrants.

As a result, a new, lean leadership team had to be mobilized. The number of top leaders was cut from nine to seven. The new lineup eliminated the most powerful voice on the left (Bo) and relegated the "extreme reformers" on the right (Li Yuanchao and Wang Yang) to the second tier. To reduce elders' interference, Hu stepped down as head of the military and Jiang Zemin promised to step back.

Moreover, a leading economic group was established to enforce bureaucratic compliance, as was a national security council (similar to that in the United States) to coordinate foreign policy. Previously, the military often kept the foreign ministry in the dark; and the party's foreign-affairs office, which handled North Korea, often failed to coordinate its activities with the foreign ministry, which handled South Korea. An anti-corruption campaign weakened opposition, and Zhu re-emerged as a hero. This set the stage for Xi's arrival.

In short, the new-style leadership, a form of managed charisma, was collectively designed to serve national needs. And it implies that Xi is unlikely to emerge as paramount leader. The Chinese presidency's authority has certainly increased; but Xi is powerful only when he has the votes. On contentious issues, he has but one of seven.

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