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# China's Emperor *for* Life

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*The new top-down, heavily centralized search for the "Chinese Dream."*

The world, including the Chinese people, watched Chinese President Xi Jinping scrap presidential term limits in March 2018 with puzzle and shock. Most observers have framed the discussion on his move as power-grabbing to make himself the emperor of modern China. So is this a tale of the emperor's new clothes, or are we just not intelligent enough to see them? Are we seeing a benign ascent of China to the global stage or the birth of another dictatorial nation? At this point, there are more questions than answers about what this means for China and for the world.

The timing of China's constitutional change could not have come at a worse moment for Sino-U.S. relations. U.S. President Donald Trump's "America First" policy has begun painting China as a "strategic competitor" that is pursuing an authoritarian path under Xi Jinping. And Xi's "Chinese Dream" policy will only intensify the fears about China among Americans, who will further link China's leadership with that of other authoritarian regimes such as Russia and Turkey. Such an atmosphere of distrust can only aggravate anti-China sentiment in the U.S. administration.

Meanwhile, there is also rising criticism from Chinese liberal intellectuals, rival political elites, and even the average Chinese citizen. If this internal dissent is combined with the increasingly negative international

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views about the Middle Kingdom, it may lead to a leadership split and political instability in China later, sending negative shockwaves through the rest of the world.

Although the concerns about Xi making himself China's "emperor" deserve serious analysis, the prevailing views also fail to take into account Chinese perspectives on internal politics, political incentives, and policy objectives. What is poorly understood—and revolutionary—about Xi's approach is his forceful change of the political and economic incentives that have governed the country for over three decades. He has a much bigger agenda than what most observers see in the power-grabbing move. This means that the concerns about China moving toward a tyrannical state also miss some important points. Crucially, China's new economic model is based on strategic usage of markets under state guidance, not on most observers' naive argument for market liberalization with a shrinking role for the state. Key-man risk is the ultimate China risk that the world has to face in the future.

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## XI'S MESSAGE TO THE PARTY

To ensure he will have enough time and power to make the necessary structural changes, Xi managed to manipulate enough support to revise the constitution to remove the presidential term limits at the National People's Congress in March 2018. His move not only showed that he had the power to break with past conventions and change the constitution, but also that he dared to challenge and alter the unwritten rules that have long guided the Party bureaucracy. For better or worse, he is moving China to a more centralized and top-down system.

Two crucial questions follow from these changes. First, as China's policy shifts from maximizing growth rates to improving growth quality, when will its growth rate fall below the 6 percent mark that Beijing has vowed to protect? Second, why does President Xi want to re-centralize power? Is this simply power-grabbing with self-interest to crown himself the "emperor" of modern China?

## WILL GROWTH FALL BELOW 6 PERCENT SOON?

Many players expect China's growth rate to fall below 6 percent—or even 5 percent—in the next three to five years if not sooner because of various reasons, including capacity constraints due to economic distortions and Beijing's desire for slower growth in exchange for structural reforms. Indeed, at the 19th Communist Party Congress in October 2017, Xi announced his vision of a "new era" in which China would achieve national supremacy by pursuing high-quality growth and de-emphasizing high-speed growth.

In practice, the focus on high-quality growth will not end the pressure to deliver economic growth, nor does it mark a shift to a smaller role for the government/Party in the economy. There is a Party goal of doubling China's per capita real GDP in 2020 from its 2010 level. This is a hard target for Xi to deliver. It means that China will have to grow by an average of 6.3 percent per year between now and 2020 to hit that target.

Structurally, China's GDP growth may remain at around 6 percent for much longer than most players have expected. First, China is going through a creative destruction process that will generate an inherent growth momentum from the new sectors. For example, China's tertiary sector (a proxy for the new economy) has grown bigger than the secondary sector (a proxy for the old economy) since 2013.

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Second, there is a developing trend of industrial migration toward the inland provinces, which also reflects China's "Made in China 2025" industrial policy of turning its tech sector into a dominant global leader. This trend has led to a reverse migration of labor, employing cheaper and untapped resources, spreading job and income growth and consumption to the poor parts of the country. These are signs of economic rebalancing. The combination of the growth of the new economy and new industries and industrial migration will likely generate growth momentum to offset some of the growth drag from structural reforms, deleveraging efforts, and even an aging population in the medium term.

### IS IT SIMPLY POWER-GRABBING?

Many observers have mostly framed the discussion on Xi Jinping's scrapping of the presidential term limits as a power-grabbing move to make himself the lifetime ruler. The move is a shock even to many Chinese because he is upending one of Deng Xiaoping's most important legacies of institutionalized leadership succession that was meant to end the political instability stemming from chronic power struggle in the Mao Zedong era. Deng instituted that system to prevent the return of one-man rule or a cult of personality by preventing leaders from staying in power indefinitely. For the West, it is a mechanism that constrains the system from moving towards dictatorship.

From Xi's perspective, the decentralized power structure that evolved after Deng has become an outdated political convention that needed to be overturned. Decentralization has not worked as intended. For the past two decades, Beijing has delegated more autonomous power to the regional governments to encourage them to try out economic reforms. They were given powers to run major regional affairs, including land allocation, business development, infrastructure construction, local fiscal policy, law making and enforcement, and allowed to own state companies.

During those years, the central government had an explicit policy of encouraging regional competition to get rich as a reform motto. Hence, GDP growth became the predominant political objective, with appointment and promotion of government officials tied to local growth performance. This created the incentive to "chase growth at all costs." It also created powerful provincial officials who acted like regional warlords, defying the central decrees. Indeed, Chinese bureaucrats have a long history of skillfully resisting orders from above and abusing power. The ancient Chinese proverb of "the mountains are high and the emperor is far away" has evolved into the modern-day practice of "whenever there are decrees from above there are counter-measures from below."

### XI JINPING'S FEAR

After five years of formulating growth and reform strategies, the leadership is poised to tackle the next phase of challenge: implementation. But the regional defiance has raised the risk of reform failure faced by Xi—in terms of failing to pull China out of the middle-income trap and risking political demise of the Party.

As power decentralization has backfired, the implementation risk has become a mounting concern. Using corruption as a proxy for implementation failure, China has remained quite corrupt, according to the Transparency International Corruption Index (which ranges from zero or highly corrupt to 100 or very clean) in the twenty years before Xi took office. Its corruption index averaged only 30 under both the Jiang Zemin and Hu Jintao administrations, but rose to 41 in 2017, reflecting the initial success of Xi's anti-corruption campaign and structural reforms.

Xi believes that there is a link between leadership power and reform implementation. The need for greater leadership power, as reflected in the elimination of presidential term limits, has become a key element of his implementation efforts. From the perspective of western democracies, scrapping the presidential term limits is a disappointing governance setback by China. But from Beijing's perspective, it may be the only option for tackling its daunting reform risk.

*Xi's high-pressure political environment may ensure compliance, but the local knowledge and power of the regional officials may no longer serve as a checking force on potentially ill-considered central policies.*

### CHANGING THE INCENTIVE SCHEME

Hence, Xi is changing the incentive scheme of the system from singlemindedly maximizing growth to multi-targeting different policy goals, including maintaining moderate GDP growth, alleviating poverty, reducing financial risk, upgrading high-tech industrial capability, and protecting the environment. By replacing the old incentive, which was easy to pursue, with a set of complex priorities, which makes optimizing all the policy goals simultaneously impossible, Xi is creating a political environment to ensure compliance by local officials. Since it will be so hard for local officials to know the best way to satisfy Beijing's multiple goals, they are more likely to just do what they are told rather than be defiant and creative.

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So there is a big agenda behind Xi's motive to stay on as a strongman leader. To realize his "Chinese Dream," he needs time and power to make changes. Eliminating the term limits makes it clear to the local officials that there are no alternative power centers for them to appeal to, and that waiting for Xi to pass from the scene is also not an option. To survive and thrive under this framework requires pledging loyalty to Xi.

Xi has, thus, created an increasingly high-pressure political environment to break local defiance and emphasize strict compliance with central decrees. His vision for the future is not to reduce state intervention, but to refine the role of the state in the economy. The new economic model will continue to be a strategic mix of markets and state guidance. Expectations of China eventually liberalizing to a complete market system are naïve conjectures, in my view.

### RELATIONS WITH THE UNITED STATES

There are heightened concerns about Sino-U.S. relations, especially on the back of rising economic rivalry and the Trump administration's aggressive measures to combat China's unfair trade practices. But there may still be silver linings in the longer term.

Crucially, Xi is not an impulsive or irrational leader. Foreign leaders tend to value rationality and predictability, and Xi is likely to deliver that, though his "Chinese Dream" policies, such as South China Sea reclamation, the Belt and Road Initiative, the Asian Infrastructure and Investment Bank, and the "Made in China 2025" policy, are certainly assertive, bold, and creative enough to make America and some other countries apprehensive. His top advisors are some of the most capable and outward-looking officials, including Vice President Wang Qishan and economic advisor and Vice Premier Liu He.

However, the Sino-U.S. relationship is likely to be rocky in the short to medium term because of an enormous difference in economic ideology between China and the United States. While China can certainly improve its intellectual property practices, Chinese authorities still believe that their tech sector is in the early stages of development, and could suffer from direct and open competition with foreign firms operating independently in their domestic markets. So when it comes to the technology sector, Beijing is applying a typical developing-market industrial policy of protecting new industries. This perspective clashes with the United States' developed market policy of championing free and fair market access. With China still confident of its ability to manage the Sino-U.S. trade conflict, the risk of escalation to a full-scale trade war is rising in the short term.

### THE ULTIMATE CHINA RISK

Key-man risk—that the person making all policy decisions is increasingly insulated from criticism or feedback, leading to potential bad decisions and disastrous mistakes—is the primary China risk that the world has to face. There are secondary risks also. Xi's high-pressure political environment may ensure compliance, but the local knowledge and power of the regional officials may no longer serve as a checking force on potentially ill-considered central policies. The pressure on officials to deliver on multiple policy targets may also worsen the old problem of data falsification and disrupt markets and even social stability.

These risks have remained manageable so far because Beijing has shown enough sensitivity to adjust policies when implementation gets off track. A relatively closed capital account also helps minimize the risk of potential capital flight in case of a loss of local confidence. But history has shown that few authoritarian regimes could maintain power and systemic stability through coercion alone. China's capital account is also opening wider as economic liberalization progresses.

In the medium term—the next ten years—Xi the emperor will likely be a benign force for China's reform and growth outlook, making China an increasingly influential player in the global stage. In the longer term, beyond ten years, only time will tell how China and the world's interactions will play out. ◆