BEIJING OPERA

CHINA CHANGES LEADERS. BUT WHAT COMES AFTER HU?

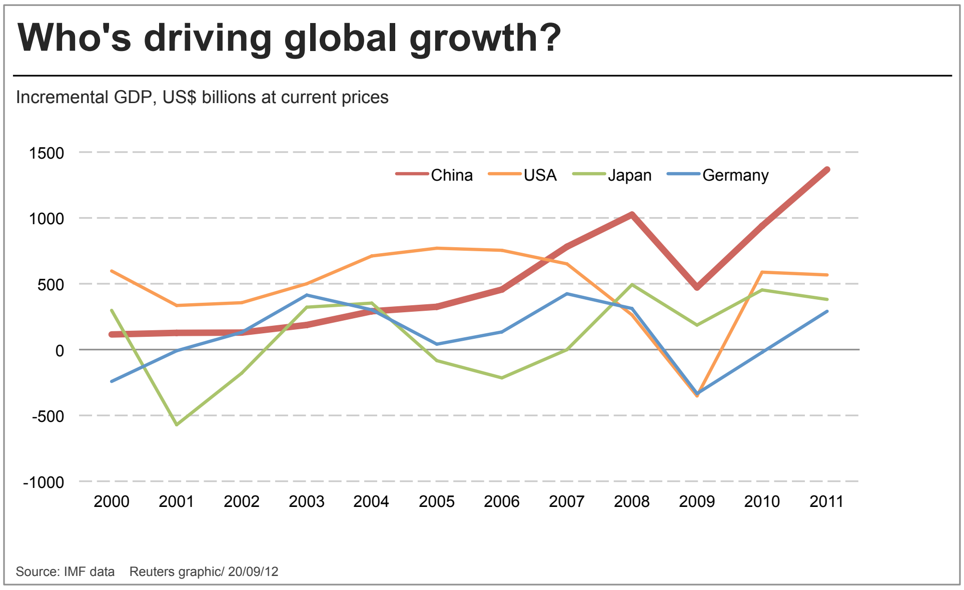
REUTERS

BREAKINGVIEWS

PREFACE

Wherever in the world you are reading this, China's leadership changeover might be the most important political event of the decade. How the country's new rulers handle the coming years will decide not just the fate of the world's most populous nation, but of its twenty neighbours, large portions of resource-rich Africa, and its biggest trade partners, Europe and the United States.

Consider the numbers. Since president Hu Jintao and premier Wen Jiabao took charge in 2002, China's GDP, in U.S. dollar terms, has quintupled. Exports to Europe have increased sevenfold, and to the United States almost fivefold. China imported 1.2 million cars in the past twelve months, almost 7.5 times as many as a decade ago. It spends 12 times what it did then on imports of sugar; 14 times on imports of copper. The Middle Kingdom is now everyone's business.



Will things go smoothly? It's not a given. The ouster of Bo Xilai, freak floods, a U.S. trade dispute and tensions with Japan have been tests. Factionalism is a constant threat, especially without Mao Zedong or Deng Xiaoping to keep it in check. Longer term, environmental damage, bad debts, corruption and the "middle-income trap" present more fundamental challenges.

Despite all that, there's cause for optimism. China still has growth, even though it is slowing. It has dodged many bullets – think of the collapse of European communism, or the Asian crisis of the late 1990s. While history shows few states have grown rich and remained peaceable, China's thirty-year economic ascent has in many ways proved historians wrong. Whether that record can continue beyond Hu and Wen is the big question underlying the articles in this book.

John Foley
China editor, Reuters Breakingviews
September 2012

THE WHAT, WHEN AND HU OF CHINA'S BIG CHANGEOVER

BY JOHN FOLEY

China's once-in-a-decade political changeover is almost here. Unlike the U.S. presidential race, there won't be televised debates, nail-biting final counts or star-studded inaugurations. But that doesn't mean there won't be drama. Here's what to expect from the geopolitical event of the year.

When does it all kick off?

After the Communist Party's 18th congress, the new members of the Politburo Standing Committee, the party's top team, will be announced. Six months or so later, they will officially take charge.

It's almost certain that the general secretary of the party - and thus president of China - will be Xi Jinping, the son of a military hero. Li Keqiang, the only other member of the outgoing nine-person committee young enough to keep his seat, is likely to become premier, the official head of the government.

Who else? The fog descends. Guangdong Party chief Wang Yang, a rival to the fallen party chief of the city of Chongqing, Bo Xilai, is a recurring name. Others are Li Yuanchao, who heads the party's colossal human resources division, and Wang Qishan, the vice-premier in charge of finance.

Much is unknown, including the date of announcement and even the actual number of men (a woman would be a huge surprise). Nine could become seven. Continuity, both of personnel, and outlook, will probably prevail, though. The recent appointment of provincial party chiefs brought few surprises - almost all are men in their fifties and sixties.

So it's all pretty much scripted?

Not necessarily. The last round in 2002, when Hu took power, was relatively smooth. Hu had been groomed by Deng Xiaoping, the party patriarch of the post-Mao years. With Deng long gone, things are more precarious.

That might explain why the party's propaganda machine has gone all out to ensure stability. Recent flare-ups of social unrest have been stamped out with force, and web searches are being censored more heavily than ever. Harmony is being maintained at great effort.

If anything, the Congress might be too quiet. Despite a slowing economy, the central government has shied away from decisive but possibly controversial policies like fiscal stimulus. If the economy gets worse, the new leaders may have to develop a concerted economic rescue plan in a hurry.

Why the anxiety? Isn't China basically a one-party state?

Sort of. China-watchers talk of three rival groups within the Communist Party. First are the former members of the Communist Youth League, including Hu himself as well as likely premier Li Keqiang. Then there are the "princelings", sons and daughters of party elders, including Xi Jinping, current finance chief Wang Qishan, and Bo Xilai. To think of them as a group may be misleading, since princelings share privilege, but not necessarily ideology.

Finally there's the Shanghai gang, which served under former president Jiang Zemin in that city, and includes figures from other cliques too. The People's Liberation Army is a fourth possible force. It has been sidelined from mainstream politics in recent years, but could make a comeback.

China's opaque system and curbs on political debate obscure who really wants what. Personality clashes are kept strictly secret - a far cry from inter-party squabbles in Japan. It's hard to see who is in and who's out until, like Bo Xilai, they are rudely purged.

So what about Bo?

The ouster of Bo Xilai disproved the theory that the new line-up had been set in stone long ago. Bo's end was reminiscent of the purges of the Mao era. His wife has been convicted of the murder of a British family friend, but Bo's alleged crimes still haven't been detailed.

While Bo's fall created excitement, it probably didn't change things much beyond freeing up a space on the standing committee. It may even have made the transition more stable. By distancing itself from Bo's supposedly "Maoist" excesses, the party managed to appear more moderate - and even more harmonious.

Why should anyone outside care?

Because the new leaders are probably the most powerful politicians in the world. China is on track to become the world's biggest economy mid-way through their tenure. If they fail, foreign investors, who poured in $116 billion of direct investment in 2011, will suffer, and sections of the population will grow restless.

It's a big challenge. China has complex needs: a social safety net, better capital allocation, local government reform. But changes in anything from the demographically dangerous one-child policy to the controversial "hukou" ID system must overturn tradition and overcome vested interests.

The new leadership will also have to decide how to deal with the rest of the world. For one, foreign investors want in, and Chinese investors want out. Looser capital controls and fewer restrictions on cross-border investment would be good for long-term development, but might create worrying floods of money in the short term.

Politically, the hot-button issues will be China's relationship with America, and tense territorial disputes with Japan and the Philippines. How well Xi balances the jingoistic factions of his government may give a clue as to whether China can continue its famed "peaceful rise". The rest of the world should hope it can.

Could Xi take China in a new direction?

It's possible. Wen and Hu emerged from a period when China was closed to the world. Xi and his cohorts are younger, and have seen the benefits of trade and openness - though they have also seen China take the blame for global imbalances. Xi will need grit and charisma to win over party hardliners, but those same traits might make for fractious foreign relations.

A good indication will be where Xi directs his early policies. China's leaders love grand gestures. Perhaps he will bail out the flagging export sector, or accelerate reforms that boost other sectors of the economy, like services. Where Hu and Wen were engineers, Xi and Li are lawyers, so they may focus on developing the rule of law.

If all else fails, listen to the slogans. Hu Jintao brought the world "scientific development" and "harmonious society", which pretty accurately sum up his achievements, and failings. Xi has many buzzwords to choose from; "rebalancing", "equality" and "reform" are all possibilites. His choice will define the next decade, and not just for China.

Published 28 August 2012

THE RULE OF THREE
BY WEI GU

China's leadership change might be a big event, but it is another occasion that matters most for the Communist Party. A new set of leaders will be ushered in during the 18th Party Congress, expected to happen in October. To hear what they stand for, the world may have to wait until the "third plenary", which brings together around 370 of the party's top figures, a year from now.

Chinese history shows the third meetings matter most. That figures: the first one is usually about selecting leaders, and the second about personnel changes in the government. By the time of the third plenary session, which has tended to happen a year after the first, the top politicians would have secured their power and formed a consensus on how to move forward.

The most significant was in 1978. At that year's third plenary session, a second-generation of Chinese leaders, led by Deng Xiaoping, turned against the doctrine that that whatever Chairman Mao said must be obeyed. Deng instead pushed the idea of finding truth from experiments, and China's focus shifted from internal debates and revolutions to development and opening up.

A third plenary in 1984 saw the concept of the planned economy abandoned. That year, China began to allow companies to issue stocks. Flash forward to 1993, and Deng put forward his views on the socialist market economy, prompted by a high-profile tour of Southern China, spanning adjustments to state-owned companies and rural reforms. It was at another third plenary in 2003 that Hu Jintao's now-famous concept of "scientific development" began to emerge. While official proclamations didn't yet use that phrase, state media and other politicians soon started to.

China's ten-year political cycles suggest that the next third plenary session will be another key event. Reform and development are always on the agenda, but income inequality and economic imbalances are creating new pressures on the incomers to come up with new ideas. While the "big reveal" is approaching fast, it's that vital third pow-wow that could really set the tone.

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BREAKING WITH THE PAST
BY WEI GU

China could benefit from a clean break. President Hu Jintao may quit his official positions in the ruling Communist Party when new leaders come in early next year, according to a report on Reuters. That would be a change from the path of his predecessor, Jiang Zemin. It would leave the incomers more room to make their mark, and push through reforms with less distraction from factional fighting.

Past leaders have found it hard to hand over the reins. Mao Zedong gave up the official presidency of China in 1959, but stayed in charge for almost two decades. His successor Deng Xiaoping started to retire from politics in the 1980s but remained as China’s unofficial “paramount leader”. Third-generation leader Jiang Zemin clung to his position as head of the army for two years after stepping down as party chief and president.

Hu is considering relinquishing all of his three titles - president, party chairman and head of the military commission - at once, according to sources cited by Reuters. That would be a good sign. While Hu has presided over ten years of rapid growth, he is not known for the kind of political or economic reforms China now needs. Hopes rest on likely new president Xi Jinping, and probable premier Li Keqiang. If Hu stands back, they have a better chance of getting a free hand.

A stronger new leadership would bring hope for reformists. There is a growing consensus in China that vested interests are getting too powerful and hindering equitable growth. The break-up of state monopolies in railways and hospitals, and reducing the dominance of state firms in banking and finance, would help unleash a new growth driver. Chinese people also demand more political freedom. The party needs to take a smaller slice if it wants the pie to grow bigger.

True, it may be mostly a question of appearances. Like Jiang, Hu will have been instrumental in placing senior politicians. He is quitting all roles only on the understanding that his protege, Vice Premier Li Keqiang, is made a vice chairman of the military commission, according to Reuters. But big gestures are still important for inspiring confidence. A clean break would be a good start to the next decade.

Published 3 September 2012

WHEN TO WORRY ABOUT CHINA'S MILITARY TRIANGLE
BY JOHN FOLEY

Who's afraid of China? Its neighbours perhaps, after Beijing announced an 11 percent increase in the military budget for 2012. And maybe the United States, which has declared a "pivot" of its forces back to Asia after years of keeping a low profile. They are right to worry, but wrong to react. China's rise has been peaceful, and will remain so provided it can maintain the delicate balance of its security triangle.

On one side of the triangle is the People's Liberation Army, with over 2 million personnel. On another is the ruling Communist Party, to whom the army reports. Then there are the people of China, who the army is there to defend, and at times keep in check. Since the days of Mao Zedong, the Party has been the triangle's strong base. It, and not the government, directly governs the army. Mao said in the 1930s that the party must control the gun, rather than the other way around, a message current Premier Wen Jiabao reinforced in a speech he on March 5.

Mao's disastrous economic and cultural policies left the party weak and the military strong. But in the subsequent decades, the military has been in retreat. There are currently no generals on the top Politburo Standing Committee. Successive cuts since the 1980s have halved the PLA's manpower, and the overt public nationalism of certain top generals – one infamously suggested China could use nuclear weapons against the United States in 2005 – has been kept in check. The PLA has also been weakened by a series of corruption scandals, including the apparent ouster of lieutenant general Gu Junshan, and stripped of its major business interests.

Besides, in the fast growing Chinese economy, the proposed 11 percent spending increase amounts to a decrease in the military's stated share of GDP. While the military rise of China makes for good headlines, the Middle Kingdom is still at the periphery of the global military picture. The United States spends at least five times as much as China on the tools of war.

But while the PLA is becoming less visible at home, it is becoming more active abroad. It is now prominent in peacekeeping missions, anti-piracy patrols and disaster relief work. China's hunger for resources has exposed it to countries such as Sudan and Iran, where its workers now come under threat from attack from guerrilla forces.

There are also cross-border political issues, which are often influenced by the threat or reality of military conflict. The multi-nation argument over the resource-rich Spratly Islands in the South China Sea is a clear example. The military role in China's complaint that groups in Pakistan are promoting unrest among China's Moslem population is more opaque, but could become significant.

The need for a stronger military presence in the world puts new strains on the domestic triangular balancing act. A repeat of the anti-imperial revolution in 1911, triggered by an army mutiny, isn't likely, but a slowing economy could create more flash points, since the popular will can influence the party's military agenda. Unrest spawned by home-grown factors like food shortages and layoffs have a history of channelling nationalist sentiment with alarming speed, with targets generally including Taiwan and Japan.

Incoming president and civilian Xi Jinping must also keep his military cool in the face of overheated U.S. rhetoric. Some American provocations can be laughed off, for example a recent book by ex-Goldman Sachs partner Peter Kiernan, *Becoming China's Bitch*. Others are more challenging: the U.S. military's return to Australia and the Philippines, patently pointed at China.

The largest current risk is not that China adopts an expansive foreign policy – it has neither the desire nor the means – but that it overreacts to others' actions. China hawks recall with a shudder the waves of nationalism that followed the crash of a U.S. military jet near the Chinese island of Hainan in 2001, or the bombing of China's Belgrade embassy in 1999.

China's commitment to peace is also changing. The country has for decades promoted non-intervention. But that can be a potent weapon. China's refusal to countenance military action in Syria over the brutal Assad regime has done much to undermine the efforts of the United States. If the global policeman loses his badge, the world will be in for heightened geopolitical risk.

For now, the doomsday clock isn't ticking. China and the United States are each other's best customers, so open conflict would risk causing mutually assured destruction. But mutual self-interest doesn't guarantee peace. Neither does the perhaps $2 trillion of U.S. government debt held by Beijing. But that does give China plenty of financial weapons to use before it reaches for the gun.

Published 8 March 2012

MARKETS

RED BULL
BY RICHARD BEALES AND WEI GU

One kind of China shop may be luring the bulls. The Middle Kingdom's stock markets look fairly cheap. And its leadership transition may coincide with an economic boost. It is hardly risk-free, but there's a case for going long Shanghai.

China stocks are in the doldrums. The price-to-earnings ratio for Shanghai Stock Exchange A shares stood at 8.8 as of July 5 based on forward estimates of profit - not far off the lowest on record, and barely more than half the long-term average. In the sluggishly growing United States, by comparison, the equivalent PE ratio for the S&P 500 Index is about 12, against a long-term average of 15. The Shanghai Composite index, though well above its 2008 nadir, could almost triple before surpassing its admittedly frothy 2007 high.

Meanwhile after deliberately cooling growth for a time, Beijing's policymakers on June 7 cut borrowing costs for the first time since the financial crisis. Central bankers rarely make only one such move, and there are other tools in the policy kitbag.It's a challenge for policymakers to stoke some sectors while reining in others, like property. But so far, China can claim a decent recent track record on economic management.

Liberalisation of stock ownership rules could feed demand. For example, the quota for qualified foreign investors is going up to $80 billion from $30 billion, bringing in new funds worth about 2 percent of the Shanghai exchange's $2.4 trillion market capitalisation. And Chinese provincial pension funds may eventually be allowed to buy stocks. Even 20 percent of their roughly 2 trillion yuan ($315 billion) of assets would represent significant new demand.

That said, domestic investors' confidence is at a low ebb. One reason is that earnings at big state-owned enterprises have been shrinking. There is also a supply overhang from as many as 700 companies waiting to float in China. Accounting and governance concerns are a potential drag too. And Europe's ongoing troubles represent a big external economic concern.

Outweighing these worries for China optimists, however, is more than typical confidence on timing. A new president, putatively Xi Jinping, will be chosen along with other top officials later this year and inaugurated early in 2013. The new leaders may be eager to stimulate the economy and markets. If they manage that on cue, China's stocks could start gathering steam late this year or early next.

Published 5 July 2012

BEIJING INSECURITY CREATES SURE CORPORATE WINNERS

BY WEI GU

China's economic slowdown has hit many companies hard. But insecurity in the Communist Party, together with the worst torrential rain in 60 years in Beijing, has helped some enterprises do very well.

The slowdown in public spending does not extend to security firms. Leading surveillance equipment provider Hangzhou Hikvision Digital Tech posted a 37 percent rise in its first-half profit. Smaller rival Zhejiang Dahua Tech grew its profit by 75 percent. Both stocks have risen sharply this year in a flat market.

The demand for such equipment is growing. For example, Beijing's July storm, which killed 77 people and led to the resignation of the mayor, has put the local government under pressure to increase video surveillance. China has five video cameras for every 1,000 people, compared with 73 in the UK and 49 in the United States, according to brokerage firm CICC. In China domestic security is already big business – the 2012 spending of $111 billion is more than the stated defence budget. Chongqing's police department awarded Hikvision a $1.2 billion contract in 2011 to build a public surveillance system including 500,000 cameras for the city's 30 million people.

Rising social tension has led the central government to step up a different sort of surveillance, on the Internet. The listed company which owns the website of the People's Daily, the Chinese government's mouthpiece, doubled its net profit in the first half, thanks to a jump in demand for its Internet watch services.

People.com.cn monitors public opinion on such sensitive topics as China's territorial dispute with Japan. Gathering information for the authorities is good business. The company also tracks local governments' social micro-blogging services to improve the effectiveness of their propaganda.

Beijing may be no longer be eager to splurge on old growth drivers like infrastructure. But when times are tough, maintaining social stability becomes even more important. Companies that can make authorities feel more secure are also likely to provide comfort for investors.

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CHINESE M&A: 18 AND STILL HUNGRY

BY ROB COX

China Inc isn't letting politics get in the way of M&A. The upcoming conclave of China's Communist Party, a once-a-decade changing of the guard, was supposed to hold back the global ambitions of state enterprises, at least temporarily. But CNOOC's $15.1 billion bid for Canada's Nexen suggests that's not happening.

The 18th Party Congress is expected to convene in the fall to select new leadership. Seven of the nine seats on the all-powerful standing committee of the Politburo are up for grabs. The two continuing members, Xi Jinping and Li Keqiang, are widely presumed to replace Hu Jintao and Wen Jiabao as China's president and premier, respectively. Xi is also likely to become general secretary of the Communist Party.

The next-most powerful body, the Politburo, will see many of its two dozen members rotate. Ditto the central committee, which includes over 300 full and alternate members. All these changes will mean new people manning the red phones that connect party leaders to the heads of China's most important ministries, regulatory agencies and state-owned enterprises. Bankers and investors have, as a result, been bracing for a slowdown in Chinese deal-making. The logic is that an ambitious executive would be foolhardy to propose a risky transaction that might soon be frowned upon by new masters somewhere up the chain of the country's inscrutable power structure.

CNOOC's agreement to buy Calgary-based Nexen goes against that rationale. While smaller than the company's eventually withdrawn bid for U.S. oil group Unocal a few years ago, it will be the largest ever full-blown foreign takeover by a Chinese company, if it's approved. Perhaps learning from the controversy over its Unocal effort, CNOOC is making big efforts to pitch the benefits of the deal to Canadian authorities, too.

In the run-up to a possibly tumultuous transition of power, such a big deal is a bold move. It brings China's outbound announced M&A volume to $38 billion so far this year, 72 percent more than last year, according to Thomson Reuters. Though other sectors feature in much smaller deals, the bulk of that is in energy. China's oil and gas champions are on the hunt for resources everywhere. Maybe, at least as seen from Beijing, even in a political season there's no such thing as a bad energy deal.

Published 24 July 2012

FIVE PHASES OF CHINA HARD-LANDING DENIAL

BY WAYNE ARNOLD

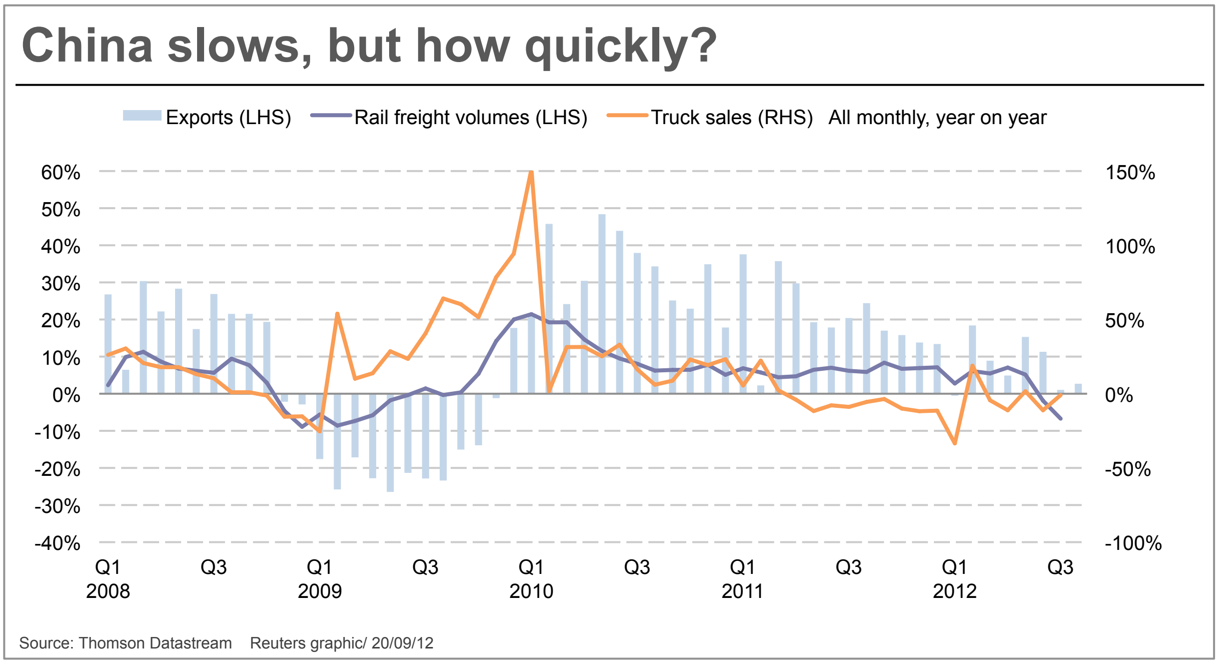
China watchers are in denial over the likelihood of a property crash. While politicians openly worry about China's too-expensive houses, economists polled by Reuters in January still think 2012's GDP will grow by 8.3 percent. That's too optimistic. Here are the frequently heard examples of wishful thinking.

1. "It'll never happen"

Many investors believe China is protected from a property crash because Chinese buyers don't rely on mortgage lending, and because there's plenty of pent-up demand to keep property buoyant. Both assumptions are wrong.

It's true mortgages haven't fully caught on. Banks lend as little as 30 percent of the value of a property. But that was true in Dubai before its 2008 crash. Buyers there paid with cash, but it was often borrowed, sometimes from informal sources. Many had other debts, too. And being overleveraged isn't the only reason to sell. Fear of losing money is another.

Pent-up demand, meanwhile, isn't evenly spread. Restrictions on buying second or third homes vary from city to city, so lifting them in one place could reduce demand in another. Buyers may also fail to bite: if falling prices make property look cheap now, imagine how much cheaper it'll look in a year.



2. "It won't be that bad for GDP"

Building accounts for over 10 percent of China's GDP. Include things like furnishings and electronic appliances and it's much more. If property prices crash, the hole in GDP would be huge. Patrick Chovanec, a Beijing-based professor, calculates that a ten percent drop in real property investment would cut GDP growth to 5.3 percent.

Economists hope two forces can counteract this. One is that China's ample household savings will enable consumers to keep spending. But the household savings rate of 30 percent of disposable income is skewed toward the wealthy. And investment accounts for more than half of China's growth, so consumers would have to boost buying at more than double the usual pace to produce the same rate of growth.

Affordable housing is the other great hope. Plans to build 36 million units of cheap accommodation by 2017 could support the building trade. But the funding is supposed to come from local governments, which are highly indebted themselves, and depend on selling land and property for their income.

3. "The banks can absorb the blow"

China's banking system is right in the line of fire. Yet the IMF estimates that a 26 percent fall in property prices would create nonperforming loans of roughly eight percent of total lending. China's bank regulator says the $1.6 trillion in property loans are backed by property worth almost twice that.

These numbers are misleading: they understate the amount of property lending and overstate the value of collateral. Most commercial loans use property as collateral, even if they're not technically real estate loans. And much lending to developers has come from non-banks like trusts, wealth-management vehicles and companies.

The property backing loans, moreover, is valued at current prices. That's fine if one borrower defaults. But as Japanese banks discovered in the early 1990s, when the entire market falls and defaults spread, the value of collateral also plunges. Non-performing loans could feasibly rise close to 20 percent.

4. "Beijing will just bail out the banks"

It has happened before – when China carved out bad loans from its lenders in the late 1990s. Now the country has $3.2 trillion in foreign reserves and virtually no foreign debt. But things aren't so simple. Reserves are technically future claims against the central bank. And while buying bad loans from banks makes the problem disappear from view, it still means a loss gets taken somewhere else in the system.

There's also Beijing's debt pile to think of. The government's official debt is only 15 percent of GDP, but it adds up quickly. Ratings agency Fitch estimates a bailout could cost 20 percent of GDP. Add the unpaid cost of the last bailout, debts at state-owned entities, local governments and pension liabilities, and a Breakingviews calculation suggests Beijing's debt rises to roughly 130 percent of GDP.

The last option – just print money and stuff it into banks – could worsen China's inflation problems, and dangerously reduce depositors' faith in the system.

5. "Beijing will make everything ok"

The trump card of the China bull case: Politicians in Beijing control the banking system, so they can order banks to lend. When the financial crisis hit, banks doubled lending in 2009.

But that's what got China into its present property pickle. Lending into a weak economy raises the risk that the money funds unprofitable projects and is lost. Banks funnelled loans to big state-owned companies who didn't need the cash. Many built property, or lent to those that did.

Moreover, the trick can't work much longer. Banks would now need to offset not just the drop in their own lending, but lending by non-banks and trusts wiped out by the property crash. Barclays estimates this shadow financing accounts for a fifth of all new funding.

Beijing is aware of the problem. For now, the property market is effectively on lockdown – transactions levels have ground almost to a halt. But spotting a problem is different from fixing it. The denialists are in for a shock.

Published 17 February 2012

CALLING FOR CHANGE

BY WEI GU

China's most venerable securities firm may need a new leader. China International Capital Corp's success was largely built on the connections of chief executive Levin Zhu, the son of China's former premier Zhu Rongji. But market shifts are pressuring CICC's earnings and market share. And its influence will be further diluted when China's new crop of political leaders is sworn in.

Political cycles often trigger changes at China's top state-owned firms, as officials want to put friends and family in those powerful positions. CICC's foreign ownership, as well as Zhu's strong personality and family backing, has sheltered him from those personnel changes.

But CICC is under pressure. Revenue last year was down 40 percent, while earnings tumbled 85 percent to just $22 million. The smaller bonus pool has to be shared by a larger number of people, too. Headcount has tripled in the past five years to more than 2,000.

Dismal performance partly reflects the malaise in the industry. But it also underscores CICC's relative decline. China's first investment bank used to have a near-monopoly on privatising large state-owned companies: the fact that many executives used to report to Zhu's father clearly helped.

But now those deals are drying up, and competition has grown. In domestic equity offerings, CICC has fallen from top spot in 2007 to fourth place this year. Its market share shrunk from 25 percent to just 6 percent, according to Thomson Reuters.

A former Morgan Stanley joint venture, CICC now has backing from China's state-owned investment company and buyout firms Kohlberg Kravis Roberts and TPG Capital. Yet its private status puts it at a disadvantage when rivals are using their balance sheets to secure business. Market reforms will lead to new opportunities such as margin trading, though listed rivals such as Citic Securities and Haitong Securities, which have more capital and broader networks, are likely to reap greater benefits. CICC's practice of giving shadow equity to employees means a listing on the domestic exchange still looks distant.

CICC could yet navigate China's leadership change. Yet Zhu's forceful, hands-on management style looks increasingly out of place. Just as his father's influence is weakened by political transition, CICC may also be due a change of leadership.

Published 18 September 2012

TROUBLES

XI'S NOT THERE

BY JOHN FOLEY

China's growth is slowing, and president-in-waiting Xi Jinping hasn't been seen in public for two weeks. China-watchers are discussing little else. The former issue matters greatly to the world, while the latter is fascinating, but basically unimportant.

Xi hasn't made an appearance since Sept. 1. He was not listed as having attended a meeting of the military commission, and cancelled sit-downs with U.S. secretary of state Hillary Clinton and the Danish prime minister. Reporters were chided for asking foreign ministry officials about his health. Rumours - range from a mild heart attack to an assault by forces loyal to ousted Bo Xilai. It's not the first time China's authoritarian public relations machine has left the public to fill in the gaps. Two decades ago, premier Li Peng disappeared from view for over six weeks. Rumours at the time included a heart attack, or a political ouster. He subsequently returned to serve for five more years.

China needs a president. What's less clear is how much it matters that it's Xi. China's one-party system relies less on individuals than in the era of Mao Zedong and Deng Xiaoping. Technocratic president Hu Jintao and his premier Wen Jiabao represented a big step away from strongman politics. The Party's standing committee is a study in homogeneity, right down to the haircuts.

Xi's views are as much a mystery as his whereabouts. What gives him legitimacy isn't his unremarkable track record, but the belief that he has the support of the Party and, crucially, the military. If Xi can ensure stability and growth, he should have public support - but so might anyone else who can deliver those things. It's a far cry from the issues-based politics of the U.S. presidential race. And of course, ordinary Chinese don't get to choose.

True, a missing crown prince shouldn't be taken too lightly. An unexpected disruption to the leadership process that resulted in internecine struggles would be damaging both for economic and political stability. And the secrecy doesn't bode well for future openness. But assuming order can be maintained, what counts most for China is "how", not "who".

Published 12 September 2012

CHINA'S ANTI-JAPAN PROTESTS COULD BRING HEAVY COST

BY JOHN FOLEY

Anti-Japan protests in China on Sept. 16, triggered by a dispute over who owns some contested islands, looked a lot like scenes from 2005. Then, anger was directed at Japan's bid for a seat on the UN security council, and the contents of a Japanese history text book. As now, it looked seven years ago as if protests were being tolerated by the Chinese government. What's different this time is economic uncertainty. The cost of letting things get out of hand is also considerably higher.

If history repeats, there's little to fear. In 2005, after four weekends of escalating protests, the government stepped in, arresting ringleaders. Japan's prime minister apologised for wartime offences, and an awkward peace resumed. Foreign direct investment from Japan to China hit a record of $6.5 billion. Tourism from Japan to China slowed, but grew.

China's leaders may be counting on a re-run. Anger around the Diaoyu islands diverted attention from the two-week disappearance, and reappearance, of vice-president Xi Jinping. As a leadership change approaches, a bit of nationalism keeps the masses, and the still-influential armed forces, occupied.

But the balancing act is tricky. In Beijing, protesters were mostly young twenty-somethings. Some carried posters of Chairman Mao - hardly reassuring for the current leadership, which has largely put Mao into storage. The fiercest incidents occurred in export-rich areas like Guangzhou and Shenzhen, where employment is under threat from a slowing economy. In April 2005, quarterly GDP growth was 10 percent. Now it is 7.6 percent.

On the economic front, Japan also has more to lose now than in 2005. Measured at current U.S. dollar values, Japan's exports to China have doubled since 2005, while Japan's nominal GDP, measured in the same manner, has grown by just 44 percent.Japan is also much more subject to the whims of Chinese consumers. Japanese carmakers sold 3 million cars in China in 2011, triple the volume in 2005, according to LMC Automotive. Retailer Uniqlo, Japan's biggest clothing retailer, had 133 stores in China at the end of February, more than a tenth of the total, versus almost none in 2005.

So far, fallout from the protests is limited. Markets seem relaxed. But both trade and politics make the stakes higher this time. If both sides don't call a truce, however insincere, the cost of escalating conflict could be unacceptably high.

Published 17 September 2012

BO XILAI: FALLING TOGETHER

BY WEI GU

The ramifications of the fall of Bo Xilai are not only political. The dismissal of the Chongqing chief also has repercussions for China's corporate sector. A local bank's shares have fallen sharply on concerns that it has a high exposure to local government debt. A high-profile Dalian businessman has reportedly been detained. That's the way with crony capitalism.

Under Bo Xilai, Chongqing went for fast growth. Nominal GDP increased by 26 percent in 2011, far ahead of the 17 percent national average. Much of the growth was fuelled the old fashioned way, with debt, often using local government-owned companies' assets as collateral. The regional government's fiscal deficit was 11 percent of GDP in 2011; in Beijing and Shanghai that ratio was 3 percent.

If Bo's debt-financed development model is discredited, the state-owned Chongqing Rural Bank is vulnerable. The bank provides a tenth of the total loans in the city. Its customers are highly concentrated, with the top 10 borrowers taking up 10 percent of the bank's total loans. Moreover, its two top shareholders are among the main eight investment vehicles used by the municipal government. The bank's 20 percent new loan growth target for 2012 is certainly at risk, and bad debts may spike up.

Then there is Xu Ming, reportedly accused of economic crimes. The chairman of Dalian Shide Group became one of the richest people in China, in large part by winning a lot of Dalian's infrastructure upgrade businesses when Bo was the chief of the north-eastern city in the 1990s.

China's crony capitalism adds to the country's economic risks. The need to please the government distracts companies from economic logic. The result is wasteful investment and abrupt rises and falls. Also, foreign businesses and outsiders tend to be treated less favourably than well-connected local firms. And the focus on politics tempts Chinese companies to be less concerned about adding value, thus less likely to succeed outside China.

Bo's case may be exceptional in some ways, but the political-economic nexus is a national problem. Bo's fall underscores the urgent need to change the system.

Published 18 April 2012

NOT IN MY REPUBLIC

BY JOHN FOLEY

China has a new neighbour to contend with: the NIMBY. Or more precisely, "linbi" - which translates as something like "neighbourhood avoidance". Angry townsfolk took to the streets in the eastern town of Qidong to protest a wastewater pipeline, and got what they wanted, following precedents set in Shifang, Dalian and Xiamen. It's a local problem, with national repercussions.

"Not In My Back Yard" is a developed world phenomenon come early to the People's Republic. Such local protests are more common in rich countries like the United States and Japan. Fracking, the process by which gas and oil is recovered from shale, has been a magnet for popular angst in North America. Canada's $7 billion Keystone pipeline was a casualty of citizens angry about leaks and climate change.

One reason for the shift may be that more Chinese have become homeowners, a process accelerated by the rapid increase in building projects. Another is simply that China's cumulative environmental damage is taking its toll. The World Bank estimated its cost at around 6 percent of GDP in 2007, but since those numbers were drawn up with official help, the real total may be much higher. The health effects of air and water pollution are still incalculable.

Chinese NIMBYs differ from their Western cousins in two ways. One is sheer numbers. Another is that trust in China runs low, because vested interests drive projects as much as need. Residents close to London's Heathrow may protest the building of a new runway, but there's little question that building one adds to the public good. A wastewater pipe from a Japanese paper mill is harder to justify, beyond generating more taxes for local governments.

Politically, NIMBYs are potentially a big problem. Governments won't want to cave in, but can't crack down so hard that protests about the environment turn into something more serious. Vibrant social media mean local governments can't respond like they used to during the land requisitions of the 1990s. Besides, no two protests are identical. Xiamen and Dalian were peaceful; Qidong and Shifang turned violent.

The demands from China's NIMBYs are at least pretty clear-cut. They don't want systemic change - just for plants to go somewhere else. Builders can coerce, compensate or cancel, and many are simply doing the latter. But where projects are really needed, either to improve quality of life or create jobs, builders and governments will have to stump up, and potentially accept lower returns. If the NIMBYs are here to stay, China's "build and prosper" growth model may soon need modifying to "ask, build and prosper".

Published 31 July 2012

THE SMOG OF DEVELOPMENT

BY EDWARD HADAS

The pollution in the great new cities of China is hard to miss. There is often a visible miasma of dirt and dust. It is not just the air; water and earth have also been badly despoiled. The Chinese authorities, which were competent enough to provide more or less adequate sewage, electricity and urban housing, have let the environment deteriorate badly. Although central government officials routinely include pollution on the list of urgent problems, relatively little has been done. Rules are made, but commonly flouted.

What has gone wrong? The leaders of the Chinese Communist Party carefully studied the fall of the Soviet bloc in the early 1990s. Why did they pay so little attention to the popular antipathy to the old regimes' tolerance of pollution? Why did they then ignore the ease with which those countries reduced emissions of dangerous substances by as much as 90 percent, without much effect on total production? Now environmental depredations spawn increasingly intense protests. Why is there no coherent response?

The usual explanation from experts is that the environment only becomes a concern after standards of living rise to a relatively high level. There is probably some truth in that, although even dirt-poor peasants object to their children suffering brain damage from ingesting toxic chemicals. In any case, the Chinese government now lags the people in their dedication to reducing pollution.

Economic analysis should be helpful. Unfortunately, economists are actually part of the problem. Two of the most popular analytic techniques work against the raising of environmental consciousness among policymakers.

Purely financial analysis is particularly harmful. Economists of this persuasion, some of whom are influential in China, fixate on interest rates, fantasise about inflation and parse financial markets. This approach is probably ill-suited for a developing market such as China, since the relations between the financial and the real productive economy are structurally unstable. In any case, financial analysis is certainly counterproductive for environmental matters. Since pollution abatement costs money and no one pays directly for environmental desecration, lower standards tend to make financial measures of production and profit look healthier.

What might be called the standard growth model is not as malign as the purely financial approach, but not exactly helpful. The technique, associated with the International Monetary Fund and widely followed in China, treats the economy as a machine which turns the inputs of labour, investment and natural resources - expressed as "total factor productivity" and the "savings rate" - into the outputs of Gross Domestic Product.

The standard approach reduces the economy to bulk categories. Pollution is on the long list of factors that are not considered worthy of separate measurement. In its most recent 75-page report on China, the IMF mentions pollution only twice, and only in passing. Conceptually, environmental disruption could be included as a cost or pollution abatement as a desired output. However, the mechanical models rely on market prices, and there is no way to assign a monetary value to clean air and water.

Economists could be more helpful, if policymakers turned to the right school. The institutional approach helps explain why pollution abatement has made so little progress, and how that can be changed. As the name implies, institutionalists study political, economic and cultural institutions - including regulatory systems. Even proponents of financial and standard economic theory admit that this sort of analysis, favoured by the World Bank, is very helpful in the study of developing economics. Without strong institutions, labour and savings will be wasted. Nonetheless, it has relatively little following in China.

Institutionally, the fight against pollution in poor countries is very difficult. The problem is that it is so tempting to increase profit by violating environmental regulations. To be effective, regulatory institutions have to respected and competent enough to be able to force rich and generally well connected industrialists to obey the law.

The respect comes from society. In the 1970s, American captains of industry started to feel ostracised by their polluting ways; they quickly added emission reductions to the list of corporate goals. China may now have reached that level of popular disapproval, although the lack of political democracy and the strict limits on non-governmental organisations make it hard to tell. The competence comes from the people. There must be enough regulatory workers who are honest enough to resist pressure and bribes and skilled enough to keep up with the wiles of regulated enterprises.

In a developed economy such as the United States, there is usually a surplus of this regulatory capacity. It is quite different in developing economies, where the necessary integrity and skills are in short supply. Regulators must compete with producers and among themselves for scarce human resources.

In China, environmental regulators have been losing that fight. The institutionalists have an answer: change priorities. The forthcoming leadership transition is an opportunity. The new men should breathe deeply, and dedicate more of the nation's resources to the reduction of pollution.

Published 29 August 2012

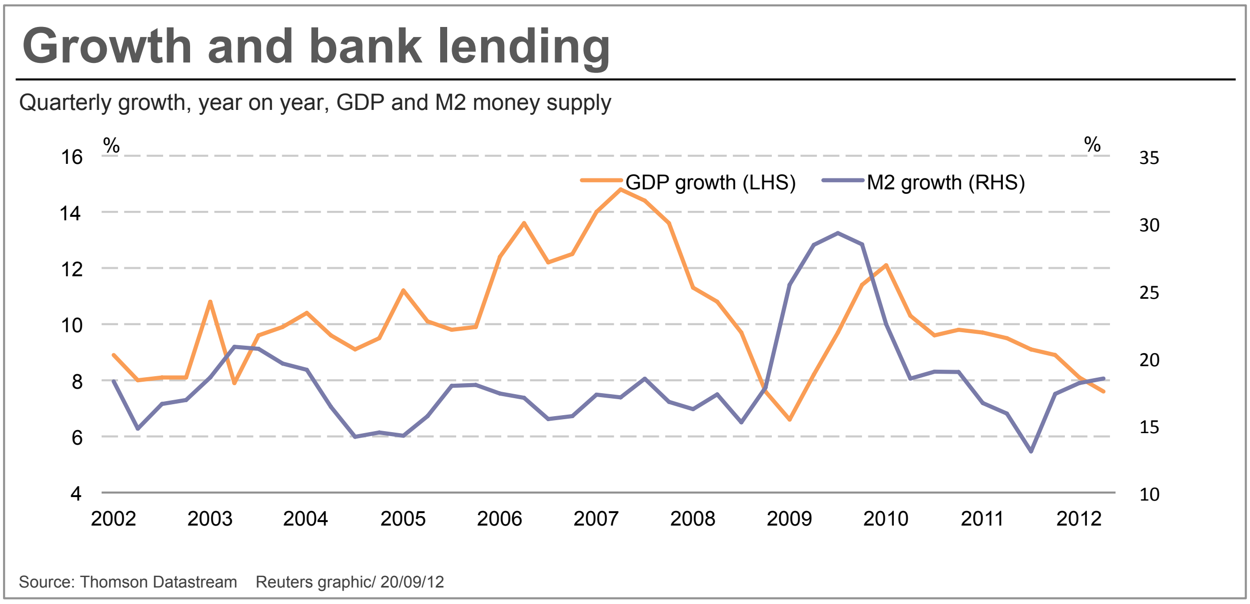
CHINA'S BANKS: DIFFICULT AGE
BY JOHN FOLEY

China's indentured banks are at a turning point. For six decades, the government has treated them as tools of the state: dictating when to lend, and when to stop. The trick is becoming less effective, even as it may be getting more necessary.

When the economy slumped in 2008, banks were part of the solution. They leveraged up the government's 1.6 trillion yuan fiscal stimulus, mainly by offering loans to local government and large industrial companies. Bank credit added 4.2 trillion yuan to the economy in 2008, and twice that in 2009 - the equivalent of 29 percent of GDP.

Now the economy is slowing again. Industrial earnings fell 5.4 percent in July, year on year. Rail cargo, a good indicator of activity, has shrunk for two months in a row. But some things are different. Though big lenders are liquid and bad debts are low, some are showing signs of deterioration. China Construction Bank's overdue loans in the export-rich Yangtze River Delta doubled in the first six months of 2012. Agricultural Bank saw its overall pile of loans overdue by less than a year increase by 39 percent.

This time it would be hard for banks to pull out the stops. Smaller banks have hit their lending limits, set at 75 percent of their deposit base. In July they lent an alarmingly small 7 billion yuan of medium-to-long term loans, the kind most likely to go into real investment. To get around these limits, many have issued off-balance sheet loans, some disguised as "wealth management products", of which there are 10 trillion yuan outstanding, according to Fitch Ratings.



The government could help by reducing the amount banks have to keep on reserve with the central bank. It could, at a push, lift the 75 percent lending cap. But the relationship between these blunt instruments and money growth is complicated. The risk is that the sheer scale of off balance sheet activity means banks might just use higher lending limits to move existing loans back onto the balance sheet.

A more dramatic approach would be to set the banks free by reducing government influence and allowing them to lend and borrow on commercial terms. Of course, that raises the risk that lenders could take far bigger risks - or hold back until the economy picks up.

That leaves a third option: bind the banks tighter. Ten years ago the state bought lashings of bad loans from burdened banks. It has room to do that again, giving them carte blanche to lend again, possibly in return for bigger equity stakes. That would stunt the banks' development, and deal a big blow to investors' confidence. But if the economy slows further, a return to enforced infancy may be the best tool policymakers have.

Published 31 August 2012

HOW CHINA CAN AVOID A CORRUPTION CRISIS
BY JOHN FOLEY

Corruption could be China's nemesis. Premier Wen Jiabao has called it the biggest threat to the Communist Party. The fate of Chongqing party chief Bo Xilai, ousted for alleged disciplinary breaches, suggests he's right, and demonstrates how high the problem goes. What was once a nuisance could soon be a crisis.

Graft is as old as China itself. Almost three millennia ago, urns were inscribed with tales of noblemen paying bribes and appropriating farmland. When the Communists came into power, one of their first campaigns was the "three antis" - one of them being "anti-corruption". Under the planned economy, it was not always easy to tell sleaze from helpful lubrication. Private entrepreneurs needed to pay bribes to get access to credit, materials and industrial equipment. Rule-breaking in the 1980s laid down the roots of some of today's most successful Chinese businesses.

Corruption got more serious as the free market grew in the 1990s. Thousands of small enterprises started to vie for capital and regulatory privileges. State-owned enterprises, suddenly facing competition, had to pay kickbacks just like everyone else. President Jiang Zemin often called graft a "cancer".

Still, China has kept up roughly 10 percent growth for a decade. One reason is that Chinese corruption tends to promote too much investment rather than too little. Think of China's swathes of redundant luxury housing. The other is that while corruption may have slowed China down, it wasn't debilitating enough to cancel out the benefits from the nation's most abundant resource: cheap labour.

China isn't hopelessly corrupt. It ranks 75th on the Transparency International index, making it dirtier than Brazil but cleaner than India or Russia. And the Communist Party has never abandoned the fight started with the "three antis". In recent years, Beijing and Shanghai saw off crooked mayors. A deputy chairman of the National People's Congress' top committee was executed in 2000.

What's different now is China's dwindling cheap labour advantage and rebalancing economy. Even if corruption is no worse than it has been, the cost of malfeasance can't be so easily absorbed.

Think about how corruption affects the economy. First, there are funds lost to the system. The central bank estimated that $120 billion had been spirited out of the country from the early 1990s to 2008. But that was drowned out by the cumulative $1.1 trillion trade surplus over the same period. As that surplus falls, the corruption drain will become more significant.

Then there's the transfer of wealth. Scholar Minxin Pei has estimated that 10 percent of all fixed investment, government spending and land fees may be siphoned off as bribes. That enriches a select few, leading to rising inequality - and political discontent.

Most threatening are the economic distortions. When everyone is on the take, the incentives to do a job well diminish markedly. Capital flows where there are graft-profits and honest small businesses are starved of resources. Corrupt businessmen can pay the government to ignore pesky environmental or labour regulations.

It's not too late to fix this problem, but it will be hard without reducing the economic influence of the state. Red tape creates too many pressure points between private and public. Fully privatising state-owned industries, and increasing transparency for processes like outward investment and licence-granting would reduce opportunities to bribe. More importantly, setting the media and internet free, rather than censoring more when scandals erupt, would shed much needed light on the system.

So far, such drastic measures are a pipe dream. Remarks from premier Wen are encouraging, but it's not clear that Bo Xilai's fall is really part of a genuine and extensive attack on high-level corruption.

Indeed, politicians may worry that such a crackdown would upset the whole economy. Chinese corruption is often "collusive" - one villain may have links to dozens more. A notorious smuggling case in Xiamen in the late 1990s uncovered hundreds of corrupt officials. Lai Changxing, the alleged kingpin recently extradited from Canada back to China, said that should he be tried, many high level government officials would lose sleep.

In some cases, accepting bribes is hard to avoid. In 2001, a county-level party secretary in Anhui province had to be moved to a different location after he received death threats for refusing.

An amnesty for corrupt officials might help. After the Tiananmen Square protests of 1989, the Supreme Court offered a pardon for officials who confessed to corruption. More than 52,800 took up the offer, according to scholar Yan Sun. Hong Kong, a great anti-corruption success story, offered an amnesty for minor offences in 1977.

An amnesty is hardly ideal. It would set a bad precedent and irritate victims of past corruption. It would have to be accompanied by the introduction of a new and more rigorous anti-corruption regime. But when bad habits are so entrenched - and the alternative is a growth crisis that threatens China's economic miracle - bending the rules looks like the lesser evil.

Published 20 April 2012

TO GET OLD IS NOT SO GLORIOUS

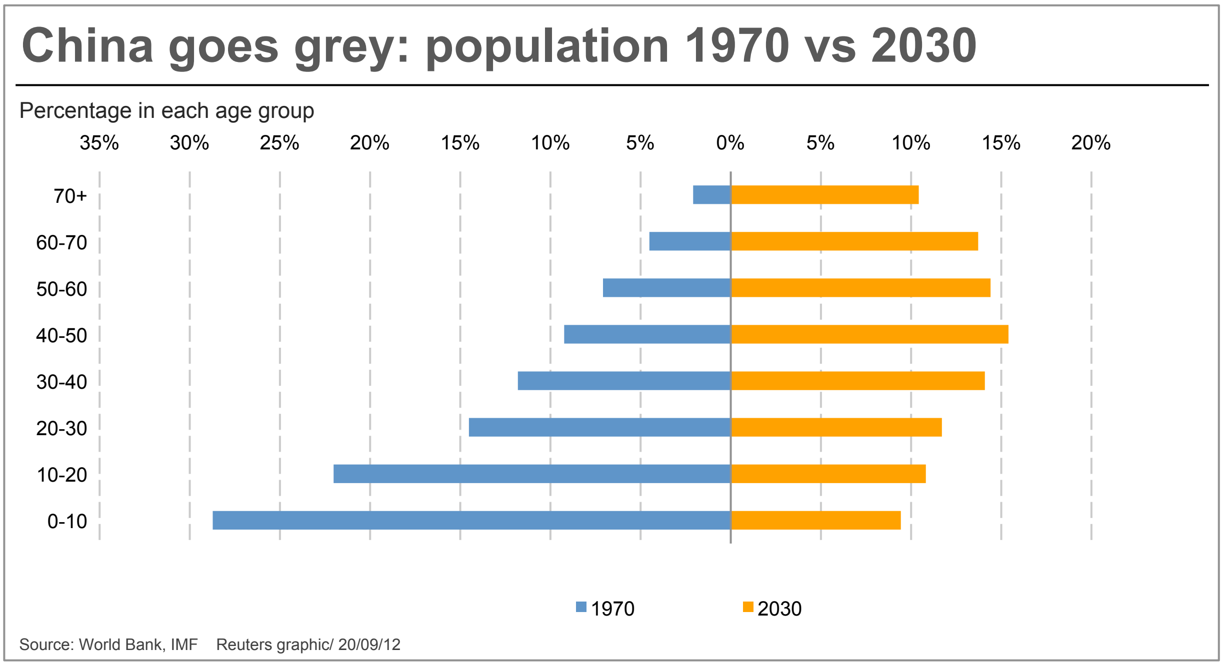
BY WEI GU

China is developing a rich country problem: old age. The number of Chinese aged 60 or over may more than double to 438 million between 2010 and 2050, according to the United Nations. That will dent China's competiveness and worsen social strains. A higher retirement age is one idea proposed by the country's State Council to counter a huge pension fund shortfall. It's not popular, but there may be little choice.

Chinese pensions don't seem high in absolute terms, but they are reasonably generous relative to salaries. An average pensioner in Beijing receives $360 a month, half of the average working wage in the city, according to official figures. To fund pensions, employees contribute 8 percent of their pay to the pension pool, and employers contribute another 20 percent. And people can retire young - women as early as age 50. That means they can easily receive their pension for more years than they work.

Perhaps not surprisingly, the system is facing a funding crisis. On a net present value basis, China's unfunded pension liabilities for the next 70 years amount to $3 trillion, a Bank of China study reckons. That's still less than countries like the United States – its social security fund had unfunded 75-year obligations worth $8.6 trillion in present value as of 2011. But China is younger, and less rich. The problem is grave.

Ageing brings other problems. For every Chinese person of 60 or over, there are more than five aged between 15 to 59 years. But the support ratio is expected to fall to just two by 2040, when the first generation of China's "little emperors" retire. The one-child policy, enforced in the late 1970s following rapid population growth in the 1950s and 1960s, coupled with longer life expectancy is skewing China's population pyramid.



The options to defuse the demographic time bomb aren't so different from those being considered in the West. Raising the retirement age is one, and just as in other countries such as France, the idea isn't popular. Some 96 percent of people polled by a Guangzhou newspaper said they didn't like the notion. Men and women should probably retire at the same age, too. And people who chose to retire early should receive lower pensions. It would help if the government stopped state-owned companies from letting employees in their 50s or even 40s "retire" as a way to push through delicate job cuts.

Raising the average retirement age by seven years will increase the working population by 25 percent and reduce the retirees' population by 28 percent, according to Deutsche Bank. The change may bring down the annual pension payout gap down to 10 percent of GDP from 20 percent, assuming no other changes, in 2050.

It may also help to rebalance the burden between the central government, provinces, and the private sector. The pension burden is falling disproportionately on local governments. Shanghai, for instance, where a quarter of the residents are 60 or older, spent $2.5 billion - 9 percent of its budget - on social security and pension in 2011. Even so, pensioners in Shanghai complain their incomes are low compared to other cities.

There's a backstop, in the form of the National Social Security Fund (NSSF). It gets funding from various sources, such as the central government's budget, equities from state-owned companies' overseas share sales, and lottery license fees. Its assets had reached $138 billion by the end of 2011, but that's still tiny as compared to the potential $3 trillion shortfall. So far, the NSSF doesn't seem to have been tapped. The State can beef up the NSSF by transferring state-owned assets, like bank shares, to the fund.

Third, local governments could make their pension funds work harder. Currently, provincial level pools of pension cash can only be invested in bank deposits or government bonds, which currently yield 3 percent a year. In comparison, the more actively managed NSSF has reported an annual return of 18 percent for its stock portfolio since its inception nine years ago till 2011, and its overall return is a respectable 8.4 percent. With the appropriate safeguards in terms of prudence, provinces could be allowed more investment leeway.

For China, being a nominally Communist country adds an extra wrinkle: citizens still expect the government to take care of them from cradle to grave. And the central government isn't entirely transparent about pension finances, perhaps for fear that shortfalls or mismanagement could provoke dissatisfaction. Making the transition to a more market-based, better equipped pension fund will be slow and challenging. Starting now should be a priority, before the red republic really starts turning grey.

Published 9 July 2012

IDEOLOGY

CAN COMMUNIST CHINA DROP MARXISM?

BY EDWARD HADAS

Speeches by Chinese Communist Party leaders are great opportunities to play "buzzword bingo". Hu Jintao's July 23 policy summary was replete with such phrases as "socialism with Chinese characteristics", "Deng Xiaoping Theory" and "Scientific Outlook on Development". But the sloganising is more than empty rhetoric. The speech, echoed elsewhere, shows the outgoing leader wants the CCP, and the country, to escape from what might be called a Marxist trap.

The trap has three parts. The first is the core Marxist belief that economic considerations come first while culture and everything else lag far behind. These days, many non-Marxists also put the economy first, but Chinese leaders are especially loyal to the simple claim that GDP growth equates to progress. Hu's focus on scientific development, for instance, is shorthand for putting higher production before all other goals. His other big buzzword - harmonious development - is not a tribute to the traditional Confucian notion of cosmic harmony, but a call not to let inharmonious social disorder slow material progress.

The second part of the Marxist trap is the Communist Party's monopoly of power in government and its final authority over everything in society. That predominance has been taken for granted by virtually everyone in the top leadership since the foundation of the People's Republic in 1949, although the thinking comes less of Marx himself than his teacher G.W.F. Hegel. Hegel believed that the state would and should eventually take over the roles traditionally played by the various organisations of civil society: family, church, guild, cultural and special interest groups. Lenin added the claim that the Communist Party is the vanguard of this all-encompassing state, so there is neither need nor space for other voices.

The final piece of the trap was set by Deng Xiaoping, the second leader of communist China. His endorsement of rapid and chaotic capitalist development, later know as socialism with Chinese characteristics, may not sound Marxist - Deng's doctrinaire opponents in the CCP were certainly horrified. But Marx himself believed that only bourgeois capitalists had the fervour and motivation required to industrialise a predominantly agricultural economy. In Marx's day, the bourgeois and the communists were enemies, but the CCP has tried to co-opt the private sector by admitting leading industrialists into the Party.

By some standards, the Deng version of Marxism has worked very well, far better than the Leninist approach, adopted in the Soviet Union and its satellites, which gave the state control of all the means of production. China's GDP has increased remarkably rapidly for almost four decades. There has been little social discord and the Party remains in firm control.

Still, as the Party prepares for the arrival of a new generation of leaders, its Marxism looks far more constraining than liberating. The narrow focus on production has led to the neglect of such important matters as corruption, environmental depredation and quality control. The Party's suffocation of civil society has neutered campaigns against abuses. It has also impoverished intellectual discourse, an important failing in a society still in the throes of the dramatic transition from poor to rich; from traditional to contemporary. And the Party's acceptance of capitalists, careerists and opportunists has accelerated a decline in ideological fervour.

Hu is certainly aware of the challenge. He noted that the country will soon be "a well-off society" with a more demanding and restive population. However his new buzzwords are unpersuasive. The all-encompassing Communist Party is incapable of building China into "a power of socialist culture" or of ensuring "the people's extensive rights and freedom". The Party is trapped because it can neither let civil society flourish nor do what civil society does.

If the Marxist trap is not sprung, China will be left lame and angry. The government will become more oppressive and more of a kleptocracy, stultifying society and depressing the economy. Escape, however, requires a truly revolutionary change. In buzzword-speak, the CCP and China should no longer remain "unswervingly on the socialist path".

What new path should the Middle Kingdom take? There are some bad ideas about, for example militaristic nationalism and a reversion to more Leninist economics. The western way, towards the European and American social model, is much more attractive. China, much like its Asian mentor and rival Japan, could end up with a mixed economy, a pushy but not omnipotent state and a society in which any lack of higher values is largely a private concern.

In a way, a choice to follow the conventional path to multi-party democracy would be regrettable. China would become less distinctive and its indigenous cultural traditions would become less relevant. More significantly, this looks a bit like a road to nowhere. Apathy blights politics in rich countries while idealism is in short supply and civil society often seems stunted. However, in China no better alternative is available. For its own good, the Communist Party should abandon Marxism.

Published 5 September 2012

LONDON OLYMPICS: BLAME GAMES
BY JOHN FOLEY

China breaks the rules. The United States loses its edge. As for Britain, it barely registers at all. It's easy to see the Olympic Games as a metaphor for economic rivalry. Fortunately, the real world is different, and can be much more harmonious – if everyone basically plays fair.

China's dominance of the medals tables – 17 golds at the last count* – resembles its economic ascent. Since the Beijing Games of 2008, China's nominal GDP has grown by around two-thirds, and its foreign exchange reserves almost 80 percent. Olympic fever and national pride are inseparable: the top ten trending topics on social network Weibo on Aug. 2 were all about the Games.

But it hasn't all been glory. Two Chinese badminton players were disqualified for apparently throwing a match, along with Koreans and Indonesian players. One Chinese player, Yu Yang, resigned from the game and was told by the government to apologise, causing much soul-searching in the Communist Party press about China's fixation with winning, both on and off the court.

In trade terms too, the clash of Olympians feels familiar. The head of the World Swimming Association questioned teen swim champ Ye Shiwen's "unbelievable" time, leading to a tit-for-tat round of name-calling by coaches and critics. On dry land, China faces 27 cases alleging unfair trading practices at the World Trade Organisation, ranging from stopping the flow of rare minerals to slapping duties on American cars.

Fortunately, there are some big differences that make the metaphor a poor one. In global trade, co-operation is rewarded. While China and the U.S. butt heads, both have benefited enormously from opening their borders.

And unlike the Olympics, economics isn't a zero-sum game. China's feat of raising over 600 million people out of poverty hasn't created an equal number of losers elsewhere in the world. While China will continue to embrace market economics, it will certainly do so with its own tweaks. India, Brazil and others will follow. But provided everyone understands the game, there can be many winners.

Published 02 August 2012

*China's final count at the end of the games was 38 gold medals, putting it second to the U.S., which won 46.

TIME FOR CHINA TO LOOK BEYOND DENG'S BIG IDEAS
BY WEI GU

It doesn't matter if a cat is black or white, so long as it catches mice. Cross the river by feeling for stones. Followers of China's economic development are familiar with these aphorisms, both attributed to Deng Xiaoping, who set the country on the path of steady and rapid economic growth after Mao Zedong's turbulent era. Those ideas were timely three decades ago. Now they too often serve as excuses for bad habits and delayed reform.

Deng first articulated his revolutionary pragmatism during debates in the 1960s over whether peasants could rent land from the state. Deng's idea was to focus on the goal - unleashing productivity - and to take China's unique history into account. He suggested experiments such as stock markets could be ended if they didn't work.

As Deng's opponents feared, pragmatism led the country away from traditional communism, including stock markets and foreign-owned corporations. As Deng hoped, it led to steady rapid growth, a welcome change from the ideologically driven famine of the Great Leap Forward and the chaos of the Cultural Revolution.

But the triumph of pragmatism over principle has also made it too easy to cut corners. The mice of growth have been caught, but less welcome creatures are running wild. A 2007 World Bank report estimated that air and water pollution causes up to 760,000 premature deaths each year in China. The "get rich fast" mentality has allowed many entrepreneurs to cross the river of fortune, but has contributed to numerous corporate scandals. Food safety has become a top concern.

When China's path was uncertain, tentative moves made sense. Now, though, the country needs firm commitments to strong institutions. A gradualist approach leads to counterproductive delays. For example, the hesitant liberalising of exchange rates probably slowed economic rebalancing.

New slogans are necessary. Outgoing leader Hu Jintao suggests "scientific development" and "harmonious society". But gentle pushes won't shake off the blind obsession with growth. It's time to focus clearly on building strong institutions and the rule of law.

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ABOUT US

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IMAGES

COVER: Chinese President Hu Jintao delivers a speech during the inauguration of the Hong Kong's new government in Hong Kong. Bobby Yip / Reuters

POWER: China's Vice President Xi Jinping speaks during the Turkey-China Economic & Trade Cooperation Forum in Istanbul. Osman Orsal / Reuters

MARKETS: A broker works at the Shanghai Stock Exchange in Lujiazui Financial Area in Shanghai. Aly Song / Reuters

TROUBLES: Chongqing Communist Party Secretary Bo Xilai drinks tea during the Chinese People's Political Consultative Conference (CPPCC) in Beijing, March 3, 2012. Jason Lee / Reuters

CHALLENGES: A demonstrator at a protest on the 81st anniversary of Japan's invasion of China, in Shanghai September 18, 2012. Carlos Barria / Reuters

IDEOLOGY: A paramilitary police stands guard in front of a giant portrait of China's late Chairman Mao Zedong in Beijing. Jason Lee / Reuters

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