

By Jennifer Richmond and Roger Baker

China's National People's Congress (NPC) remains in session. As usual, the meeting has provided Beijing an opportunity to highlight the past year's successes and lay out the problems that lie ahead. On the surface at least, China has shown remarkable resilience in the face of global economic crisis. It has posted enviable gross domestic product (GDP) growth rates while keeping factories running (if at a loss) and workers employed. But the economic crisis has exposed the inefficiencies of China's export-dependent economic model, and the government has had to pump money into a major investment stimulus package to make up for the net drain the export sector currently is exacting on the economy.

For years, China's leaders have recognized the risks of the current economic model. They have debated policy ideas to shift from the current model to one that is more sustainable in the long run and incorporates a more geographically equitable growth and a hefty rise in domestic consumption. While there is general agreement on the need for change, top leaders disagree on the timing and method of transition. This has stirred internal debates, which can lead to factionalization as varying interests align to promote their preferred policy prescription. Entrenched interests in urban areas and the export industry — along with constant fears of triggering major social upheaval — have left the government year after year making only slight changes around the margins. Often, Beijing has taken one step forward only to take two back when social instability and/or institutional resistance emerge.

And this debate becomes even more significant now, as China deals simultaneously with the aftermath of the global economic slowdown and preparations for a leadership transition in 2012.

### The Hu Agenda

Chinese President Hu Jintao came into office eight years ago with the ambitious goal of closing a widening wealth gap by equalizing economic growth between the rural interior and coastal cities. Hu inherited the results of Deng Xiaoping's opening and reform, which focused on the rapid development of the coastal areas, which were better geographically positioned for international trade. The vast interior took second billing, being kept in line with the promise that in time the rising tide of economic wealth would float all ships. Eventually it did, somewhat. But while the interior saw significant improvements over the early Mao period, the growth and rise in living standards and disposable income in the urban coastal areas far outstripped rural growth. Some coastal urban areas are now approaching Western standards of living, while much of the interior remains mired in Third World conditions. And the faster the coast grows, the more dependent China becomes on the money from that growth to facilitate employment and subsidize the rural population.

Hu's predecessor, Jiang Zemin, also recognized these problems. To address them, he promoted a "Go West" economic policy designed to shift investment further inland. But Jiang

faced the same entrenched interests that have opposed Hu's efforts at significant change. While Jiang was able to begin reform of the bloated state-owned enterprises, he softened his Westward economic drive. Amid cyclical global economic downturns, China fell back on the subsidized export model to keep employment levels up and keep money flowing in. Concern over social instability held radical reform in check, and the closer Jiang got to the end of his term in power, the less likely he was to make significant changes that could undermine social cohesion. No Chinese leader wants to preside over a major economic policy that fails out of fear of being the Chinese Mikhail Gorbachev.

For those like Hu who have argued that rapid reform is worth the risk of potential short-term social dislocation, the global downturn was seen as validating their policies — and as confirming that the risks to China of not changing far outweigh the risks of changing now. The export industry's drag on GDP has forced Beijing to enact a massive investment and loan program. By some accounts, fixed investments in 2009 accounted for more than 90 percent of GDP. Those arguing for faster reform have noted that the pace of investment growth is unsustainable in the long run, and that the flood of money into the system has created new inflationary pressures.

Much of this investment came in the form of bank loans that need to be serviced and repaid. But as the government tries to cool the economy, the risk of companies defaulting on their loans looms. Cooling the economy also threatens to burst China's real estate bubble. This not only compounds problems in related industry sectors, it could also trigger massive social discord in the urban areas, where housing has taken the place of the stock market as the investment of choice.

### Beijing's Ongoing Dilemma

Chinese leaders face the constant dilemma of needing to allow the economy to maintain its three-decade long export-oriented growth pattern even though this builds in long-term weaknesses, but shifting the economy is not something that can be done without its own consequences. Social pressures are convincing the government of the need to raise the minimum wage to keep up with economic pressures. At the same time, misallocation of labor and new job formation incentives in the interior are causing shortages of labor in some sectors in major coastal export zones. If coastal factories increase wages to attract labor or appease workers, they run the risk of going under due to the already razor-thin margins. But if they don't, the labor fueling these industries at best may riot and at worst might simply move back home, leaving exporters with little option but to close shop.

Looming demographic changes around the globe also impact the Chinese situation, and the government can no longer rely on an ever-increasing export market to drive the Chinese economy. Some international companies operating in China already are beginning to consider relocating manufacturing operations to places with cheaper labor or back to their home countries to save on transportation costs Chinese wages are no longer mitigating.

With its export markets unlikely to recover to pre-crisis levels any time soon, competition and protectionism are on the rise. The United States is growing bolder in its restrictions on Chinese

exports, and China may no longer avoid having the U.S. government label it a currency manipulator. While this may be an extreme measure in 2010, the pressures for such a scenario are rising.

Amid its domestic and global challenges, Chinese leaders are engaged in economic policy debates. It appears that internal criticism is being directed against Hu as social tensions over issues like rising housing prices and inflation grow. In some ways, this is not unusual. National presidents often bear the brunt of dissatisfaction with economic downturns no matter whether their policies were to blame. In China, however, criticism against economic policy falls on the premier, who is responsible for setting the country's economic direction. The focus on Hu reflects both the depth of the current crisis and the underlying political tensions over economic policy in a time of both global economic unpredictability and preparations for the end of Hu's presidency in 2012.

To bridge the gulf between the urban coast and the rural interior, Hu and his supporters have pursued a multiphased plan. First, they sought to rein in some of the most independent of the coastal areas — Shanghai in particular, which served as a center of power and influence not only in promoting the continuation of unfettered coastal growth but also of Hu's predecessor, Jiang. Second, a plan was put in motion to consolidate redundancies in China's economy and to shift light- and low-skilled industry inland by increasing wages in the key coastal export manufacturing areas, reducing their cost competitiveness. And Beijing added an urbanization drive in traditionally rural and inland areas. Together, this represented a joint attempt to bring the jobs to the interior rather than continue the pattern of migrant workers moving to the coast.

The core of the Hu policies was an overall attempt to re-centralize economic control. This would allow the central government to begin weeding out redundancies left over from Mao's era of provincial self-sufficiency, which the Deng and Jiang eras of uncoordinated and locally-directed economic growth often driven by corruption and nepotism exacerbated. In short, Hu planned to centralize the economy to consolidate industry, redistribute wealth and urbanize the interior to create a more balanced economy that emphasized domestic consumption over exports. However, Hu's push, under the epithet "harmonious society," has been anything but smooth and its successes have been limited at best.

### Hu Meets Resistance

Institutional and local government resistance to re-centralization has hounded the policy from its inception, and resistance has grown with the economic crisis. Money is now pouring into the economy via massive government-mandated bank lending to stimulate growth through investments as exports wane. Consequently, housing prices and inflation fears now plague the government — two issues that could lead to increased social tensions and are already leading to louder questioning of Hu's policies. With just two years to go in his administration, Hu already is looking to his legacy, weighing the risks and rewards between promoting long-term economic sustainability or short-term economic survival. The next two years will witness seemingly incongruent policy pronouncements as the two opposing directions and their proponents battle over China's economic and political landscape.

Hu's rise to the presidency was all but assured long before he took office. From a somewhat simplified perspective, the PRC has had only four leaders: Mao Zedong, Deng Xiaoping, Jiang Zemin and Hu Jintao. When Mao died, his appointed successor, Hua Guofeng (who was settled upon after several other candidates fell out of favor), lasted only a short time. Amid the political chaos of the post-Cultural Revolution era, Deng rose to the top. Both Mao and Deng were strong leaders who, although contending with rivals, could rule almost single-handedly when the need arose.

To avoid the confusion of the post-Mao transition, Deng created a long-term succession plan. He ultimately settled on Shanghai Mayor Jiang Zemin as his successor. But in an effort to preserve his vision and legacy, Deng also chose Jiang's successor, Hu Jintao. Barring some terrible breach of office, Hu was more or less guaranteed the presidency a decade before he took office, and there was little Jiang could do to alter this outcome. Jiang, however, made sure that he left his mark by lining up Hu's successor, Xi Jinping. Despite Jiang's support, Xi has not risen through the ranks in the same manner as Hu did, raising speculation of internal disagreements on the succession plan.

Vice President Xi is considered one of the "princelings," leaders whose parents were part of the revolutionary-era governments under Mao and Deng who mainly have cut their teeth through business ventures concentrated in the coastal regions. Hu, on the other hand, is considered among the "tuanpai" or "tuanxi," leaders who come primarily from the ranks of the Communist Youth League and interior provinces. While these "groups" are not in and of themselves cohesive factions, and China's political networks are complex, Hu's and Xi's backgrounds reflect their differing policy approaches. As such, the question of the next Chinese leader is shaped by opposing economic plans.

On one hand are those like Hu who support a more rapid and immediate refocusing on rural and interior economic growth, even at the cost of reduced coastal and urban power. On the other hand, those like Jiang and his protege Xi have an interest in maintaining the status quo of regionalized semi-independence in economic matters and continued strong coastal growth. They are proceeding on the assumption that a strong coastal-led economy will both provide more immediate rewards for themselves and strengthen China's international position and its national defense.

It is important not to overstress the differences. Each has the same ultimate goal, namely, maintaining the CPC as the central authority and building a strong China; it is just their paths to these ends that differ. But the economic policy differences are now becoming key questions of Party survival and Chinese stability and strength. Factional struggles that in normal circumstances can be largely controlled, or at least would not get out of hand, are now shaping up in an environment where China's three-decade economic growth spurt may be reaching its climax. Meanwhile, social pressures are rising amid uncertainties and instabilities in Chinese economic structures.

Beijing has emerged from the economic crisis bolder and more self-confident than ever. But this is driven more by a recognition of weakness than a false assessment of strength. China's leadership is in crisis mode, and at this time of economic instability and uncertainty, the

leadership must also manage a transition that is bringing competing economic policies into stark contrast. And this is the sort of pressure that can cause the gloves to come off and throw expectations of unity and smooth transitions out the window.

Everything may pass smoothly; two years is a long time, after all. But if there is one thing certain about the upcoming change of presidents, it is that nothing is certain.

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