

COEXISTING WITH CHINA IN THE 21ST CENTURY*

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Since Deng Xiaoping and reformers Hu Yaobang and Zhao Ziyang launched radical market reforms in China, the country became a capitalist economic system with a communist political regime, a regime never observed before in history. We discuss the nature of that regime, how stable it is likely to be over time and what the challenges are for democracies of international coexistence with this new regime in the twenty first century.

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1. INTRODUCTION

China's economic growth and development miracle is the most significant economic event since the industrial revolution that started in England at the end of the 18th century. The Chinese economy has had a consistent growth of over 10% during nearly 30 years, and is currently growing at a rate of 6–7% per year. Being in the low hundreds in the 1970s, after the disaster of the Cultural Revolution, GDP per capita is now above \$8,000 and around \$15,500 in terms of purchasing power parity. It is only a matter of years before China's GDP becomes the largest in the world and overtakes the US GDP unless it has already done so.

Four decades after the beginning of China's growth miracle, several questions are raised about its future evolution. When Deng Xiaoping launched economic reforms transforming China's socialist economy in a thriving market economy in 1978, many observers, including me, thought that political reforms would ensue, albeit gradually, following a specific Chinese path. In reality, it has become clear, especially since Xi Jinping became Secretary General, that China's economic reforms will *not* be followed by any political reform. Instead, China is emerging as a robust capitalist economy under a communist political regime. This is an absolutely new system in world history, unimaginable even a few decades ago. This innovation has not been studied much. What are the challenges facing a communist regime overseeing a capitalist economy? Will there be systems competition between communism and democracy? What are the chances China will overtake advanced market economies like the US? What will be China's behavior in the world arena? Will China be expansionist? How stable will China's political system be? All these questions have important implications for the world economy and the international order in the 21st century.

In section 2, we define in more detail China's system of capitalism under a communist regime. In section 3, we ask whether there is any chance the Chinese economy will overtake richer countries in terms of GDP per capita. In section 4, we discuss the challenges that this poses, in particular the ideological void of China's regime and corruption. In section 5, we explain why we think the current Chinese system is relatively stable, and thus likely to last for a long time. In section 6, we discuss on that basis the challenge of international coexistence with China's regime in the twenty first century. Section 7 concludes.

2. A CAPITALIST ECONOMY UNDER A COMMUNIST REGIME

In the light of stagnation of the USSR in the 70s and the chaotic (and lunatic) Maoist management of the economy since 1958, Deng Xiaoping thought that the

best strategy to consolidate the power of the Chinese Communist Party (CCP) was to introduce the market economy in continental China, following the examples of Taiwan, Hong Kong and Singapore. Deng was pragmatic. He had observed the success of the above-mentioned three economies (called the Asian tigers at the time), all countries with large Chinese populations, and argued that if the CCP was not able to deliver growth rates as robust as those countries, it would inevitably lose power. This vision proved to be quite prophetic. In the late 70s, it was not yet clear that the Soviet system would collapse and that communist regimes in Central and Eastern Europe would disappear. Many of Deng's colleagues wished a return to the central planning system of the 1950s. This seemed to be a safer bet, advocated by Party elders like Chen Yun, Deng's main opponent when it came to market reforms. The compromise they agreed on was to experiment with de-collectivization in the countryside and to incentivize peasants via the "*household responsibility system*". Maoist communes (large socialist cooperatives encompassing several villages) were disbanded and households received land for a 15-year lease. They were obliged to deliver a fixed quota of grain to the state at a fixed price, but were allowed to freely produce and sell at free prices on markets any additional output they wanted. The implementation of the household responsibility system proved to be phenomenally successful and created momentum for further reform leading to China's growth miracle (on the political economy of reform momentum in China (Dewatripont – Roland 1995; Xie – Xie 2017)).

Deng eventually used the power of the CCP to unleash market forces relying mainly on two elements: government decentralization and yardstick competition (meritocracy).¹ Contrary to superficial reports, China's economic success was not due to the State withdrawing from the economy, but to the CCP using all possible instruments at its disposal to achieve high rates of economic growth. Not surprisingly, this process eventually reinforced the power of the CCP in all spheres (military, education, press, etc.) instead of decreasing it, which had been Deng's avowed goal all along. Private entrepreneurs can – since 2001 – become CCP members, a move that can be seen as a way for the CCP to keep control over the private sector.

The initial thinking on the link between economic and political reform in China was that political reform would sooner or later follow economic reform. After all, the Soviet Union did have a political transition shortly before economic transition. The order in China seemed to be different, but most observers thought that economic reforms would lead to gradual political liberalization. In hindsight that view appeared to be deeply mistaken. If anything, the opposite happened. *The*

¹ See the classical paper by Xu (2011) for the consensus view among researchers on the reasons behind China's success.

transition to the market economy in China was decided with the goal of preserving and consolidating the power of the CCP. This is no surprise, as Chinese communist leaders always asserted that objective. So far, this has been an unmitigated success! China's economy has been transformed in 40 years beyond recognition, and this has changed the world economy, and will influence the world's political arena in the 21st century.

China's current system is one of *CCP power over a market economy*.² Growth objectives were pursued using existing CCP institutions. CCP power has not faded with progress of market economy. On the contrary! Thanks to China's economic miracle of the last decades, the CCP has probably become the most powerful organization in all of world history.

The reinforcement of Communist State power has led to a state structure that is very different from that in Eastern Europe, even in the post-communist autocratic states. This state structure is unique, and combines China's imperial state structure of the past and a very modern version of Leninism. The Communist Party stays very united and controls all the power levels. The Leninist principle of democratic centralism keeps the party united, as it forbids the formation of political fractions within the CCP. Fractionism is a major sin for Leninists. CCP members are officially allowed to express their opinion only in their own party unit. They are certainly not allowed to organize meetings outside the CCP's organizational structure. The CCP is present everywhere in Chinese society, not only inside the state apparatus, but also in private enterprises, sports clubs, apartment buildings, etc. The CCP is very much present, albeit in a more secret form, in Hong Kong and Taiwan that it plans to take over in due time. The power of the CCP thus exceeds any governmental structure that we can think of, both in history and in modern times. Because the CCP exercises power by being everywhere in society, it is also – in my view – of a less expansionist nature, since it would be a very costly form of expansionism. I will dwell on this important point further below in Section 6.

If the CCP has never been more powerful than it is now, why is there more and more censorship and restriction of freedoms under Xi Jinping? One may think that China's communist leaders are powerful enough that they could afford to somewhat relax censorship and repression. Autocracies, however, function very

² Because of the specificities of Chinese capitalism, some people tend to call it *state capitalism* (due to the still large role of the state sector) or *crony capitalism* (due to personal relationships between entrepreneurs and party cadres being used to give favors to the former, often in exchange for bribes). See also the interesting concept by Kolodko (2018) of *Chinism* to characterize the Chinese economic system. I do not object to those denominations. My emphasis is on the fact that China has become a truly capitalist economy, albeit with its own characteristics, competing successfully on the global market.

differently from democracies and have their own logic. In a democracy, freedom of speech and freedom in general do not threaten elected leaders. They can be insulted, jeered and mocked, but this does not threaten their power, as they acquired it through contested elections. The mere fact that they were elected implies that they have a power base. Taking away freedoms from citizens would be a sure way to lose votes and political power. In an autocracy, leaders are not elected by universal suffrage, and they cannot count on such visible and official signs of public support as an election. Power inside an autocracy is usually lost to rivals inside the power structure. Autocratic leaders who are perceived as weak are more likely to be challenged by rivals. Therefore, they need to signal strength to deter potential challengers. An autocratic leader thus cannot leave any criticism of his rule unchallenged, even if that criticism does not directly represent a threat to his power. This is why absence of democratic selection of leaders under autocracy always goes hand in hand with repression, censorship and restriction of freedoms.

3. CHINA'S GROWTH IN THE LONG RUN: WILL IT BECOME RICHER THAN THE WEST?

China's growth record since it introduced market reforms has already transformed the country from a poor country into a middle-income country. Growth rates were around 10% for the first three decades of economic reform, but they keep humming at around 6 or 7% annually. There is no reason to believe that China may not become a high-income country like Japan and South Korea did in their time. China's relatively high level of human capital and the pursuit of growth objectives appear solid conditions for becoming a high-income country. Absent a major political crisis in China, which is unlikely, as we will see below, China will continue reducing its income gap with richer countries in the 21st century.

Given its size, China will in the medium term overtake the US in terms of GDP. Estimates of GDP using purchasing power parity suggest that China's GDP may already be larger than that of the US. The size of the country was an asset in the transition since the removal of allocative distortions of socialism and the introduction of modern technologies across very large territories led to big increases in total factor productivity for a number of decades, at 3–4% growth per year. In the long run, the size of the country could become an economic liability in international economic competition, as poorer regions may drag down the rest of the country. Hu Jintao's "Harmonious society" program aiming at allocating a lot of money to more backwards regions has tended to lower the total return to capital in China from roughly 15.7% in 1993 (Bai et al. 2006) to 5.1% in 2010 (Bai – Zhang 2014), which is not very high in international perspective.

Given China's extremely high growth rates in recent decades, the big question is whether China will at some point overtake advanced Western economies in terms of GDP per capita. We know from endogenous growth theory that the answer to that question depends on the degree of innovation. This is well understood by Chinese leaders who launched the "Made in China 2025" program aiming at making innovations in 10 key sectors to make their country the dominant player in those sectors. These include: 1) advanced information technology, 2) automated machine tools and robotics, 3) aerospace and aeronautic instruments, 4) maritime equipment and high-tech shipping, 5) modern rail transport equipment, 6) new energy vehicles and equipment, 7) power equipment, 8) agricultural equipment, 9) new materials, 10) biopharmaceutical products and advanced medical products. China is already extremely competitive and at the world frontier in the production of solar panels and high speed trains for example. I am convinced this program can help China reduce the income gap by producing frontier goods at extremely competitive prices, but I am highly skeptical that China will overtake advanced economies like the US and Europe in terms of fundamental innovation. There are several reasons for this.

First of all, China has had a collectivist culture. As we showed elsewhere countries with individualist culture have higher levels of innovation and long run growth than countries with collectivist culture (Gorodnichenko – Roland 2017). The reason is that individualism gives more social status to standing out while collectivism gives more social status to conformity and social embeddedness. China has had a collectivist culture for millennia, especially with Confucianism. Collectivist culture can help economically in many ways. It is the secret behind the impressive coordination capacity seen in Chinese manufacturing, where complex operations are coordinated to assemble high tech goods with a very low rate of rejects. Nevertheless, collectivist culture is at a disadvantage when it comes to incentives for fundamental innovation because of the stronger role of conformism in its culture.

The second reason, even more important in my view for why China is unlikely to overtake the most advanced economies, is that fundamental innovation requires complete freedom of thought and expression, as a *necessary though not sufficient* condition for fundamental innovation. Political repression and censorship have stifling effects and reinforce aspects of collectivist culture. Chinese leaders under Xi Jinping have the illusion that they can do two contradictory things at the same time: 1) encourage research in STEM areas (science, technology and engineering and mathematics), not interfering in science as was the case with for example the Lysenko affair in Stalinist Russia, while 2) imposing complete censorship in social sciences, giving the CCP all the power to determine what are the right ideas in economics, political science, social science, history, etc. The greatest natural

scientists in Soviet Russia like Sakharov were also the most critical of the Soviet regime. Under the Nazi regime, scientists left the country *en masse*, not just Jewish professors. Which great mind would like to return to China knowing that freedom of expression is very limited? *It is wishful thinking to believe that China can be at the frontier of innovation while suppressing freedom of thought.* It is an indication of the hubris and arrogance of current Chinese leaders. There is therefore, in my view, hardly any chance that China will overtake the West in terms of innovation, and thus in income per capita terms. If I am right, this is probably bad news for the dreams of grandeur of CCP leaders, but it should be seen as good news for those who might fear Chinese economic success will eventually lead to economic domination. If there is no chance of China taking over the West in terms of innovation, then it is completely counterproductive to try to sabotage or limit innovation in China as is being done today by the Trump administration. On the contrary, innovation in China is good for growth and good for the world economy. It is not something that should be feared, but should instead be welcomed. China's closing of the development gap with the West should also create healthy competition and cooperation in scientific and technical innovation. This was the case in the Sputnik age and should be the case 60 years later with China.

4. THE CHALLENGES OF THE MARKET ECONOMY TO COMMUNIST POWER IN CHINA

Even though Deng Xiaoping's gamble to introduce a market economy under the leadership of the Communist Party represented a major historical innovation, which proved to be hugely successful in China, this does not mean that communist leadership over a market economy does not create specific challenges. We discuss the three most important ones: the challenge of promoting an obsolete ideology (Marxism, communism), the challenge of corruption and the growth of the private sector.

4.1. The challenge of an obsolete ideology

Communist ideology is opposed to the market economy and to capitalism. Communist ideology claims that socialism should replace capitalism and that this will give workers a higher welfare level. The Marxist claim that the socialist planned economy should be superior to the market economy is a fundamental tenet of that ideology, and cannot easily be pushed under the carpet. Therefore, the introduction of the market economy in China, after decades of turmoil and economic catastro-

phes, creates a huge tension between the successful economic system established under Deng and communist ideology. The experience of the 20th century shows that people are on average much better off under the market economy than under the socialist economy. In a nutshell, the success of the market economy makes communist ideology obsolete. This is even truer after the collapse of central planning in Central and Eastern Europe. One cannot claim that the economic disasters experienced during the Maoist period were only due to Mao's economic illiteracy. The "classical socialist economies" of Eastern Europe all proved to be inferior to capitalism and eventually collapsed. Only North Korea can still claim to have a socialist economy, but it is one of the poorest countries on the planet, while South Korea has become an advanced market economy. So, how serious is the challenge of defending an obsolete ideology for the Chinese communist leaders?

This might seem to be an enormous challenge given the huge contradiction between communist doctrine and the successful economic reforms undertaken under Deng, and the top party leaders who played a big role in unfolding the reform process (such as Hu Yaobang, Zhao Ziyang or Zhu Rongji). One can, however, think of arguments for why this challenge is not as big as one may think at first sight. A useful paper to understand this is Haifeng Huang's (2015) "Propaganda as Signaling" paper. The main idea of this, which is very much rooted in governing styles throughout Chinese history, is that the content of the propaganda may matter less than its role as a signal of loyalty to leaders.

To illustrate the idea, it is useful to recall a particular episode from the Qin dynasty. Zhao Gao, an adviser to the Emperor is said to have brought a deer to the Imperial Court and in front of the whole court said: "This is a horse". Some in the court contradicted him, while others said: "Yes, this is a horse". Zhao Gao had the first group executed. The adherence to a blatantly false assertion served as a signal of loyalty. Communist ideology plays a similar role in contemporary China. Most people know it is an obsolete ideology, but those in positions of power keep repeating the ideological slogans of the day to signal their loyalty. Such a form of signaling may appear shocking to Western readers, but it is easy to cite a number of falsehoods other than communist ideology that people adhere to in the West, whether in the religious or the political sphere. The spread of fake news and open lying by President Trump shocks many but helps cementing ingroup loyalties among his core group of supporters. Wu (2015) showed in the context of Chinese history how Confucianist etiquette was not only a signal of loyalty, but also a way of minimizing open challenges to the Emperor.

There is nevertheless a major weakness to the persistence of the use of communist ideology in modern China. Leaders cannot use ideology as a way to enhance their legitimacy because people do not genuinely believe it. This leaves them mostly with exercise of power and terror to not appear weak and vulnerable

to rival takeover. In the long run, the use of an obsolete ideology by communist leaders will undoubtedly prove a major weakness, unless they manage to transform it into a neo-Confucianist ideology that fits more closely with Chinese reality and aspirations, but gets rid of most of Marxist ideology.

An important caveat is in order here. The fact that CCP leaders are following an obsolete ideology does not mean that propaganda has no effect. Propaganda is not equivalent to ideology. Much of the propaganda is not directly related to the fundamental tenets of communist ideology, but is related to concrete topics such as the trade war with the US, issues of foreign affairs, the anti-corruption campaign, China's successes in technology, etc. In that sense, propaganda is often very effective and is believed by the population, even when it is full of lies. Communist regimes have in general been quite effective at propaganda, especially since censorship does not make it possible for people to criticize the propaganda and disseminate other points of view.

4.2. The challenge of corruption

A second challenge is that of corruption within the CCP. Some people were surprised by the intensity of the anti-corruption campaign started by Xi Jinping at the start of his first term as Party Secretary. In 2017, the Central Commission for Discipline Inspection (CCDI) of the Party reported that by then more than 1.5 million officials had been disciplined under the Party rules and 58 thousand officials had been charged with crimes. Corruption has in recent years made major inroads within the party, especially during the Hu Jintao presidency. It is a major challenge for the CCP as it can strongly erode its legitimacy but also the whole functioning of the state apparatus and law enforcement. The full scale of corruption in China is not clear, but all the casual evidence from Chinese news sources tends to show that it is a major issue forming an existential threat to the power of the CCP.

Corruption in China had reached the point where officials purchase government and party positions for money, instead of being selected for promotion based on merit (McGregor 2012). Promotion has usually been seen as the biggest incentive for party cadres and government officials. This is the reward that has been sought for achieving higher economic growth rates than in other provinces, districts or prefectures. Officials who consider that they have lower chances of promotion may be more tempted to take bribes (Persson – Zhuravskaya 2015) on the incentives of different types of bureaucrats. Corruption has very strong negative effects on the legitimacy of the CCP. Not only does it erode the party's legitimacy among the population, but it also erodes the power of the Party lead-

ers to give orders and get obeyed (Li et al. 2018). Indeed, once corruption chains form, they are very collusive and threaten the authority of Party leaders because members of a corruption chain will tend to be more loyal to members of that chain. Once a corruption chain is big enough, it can even threaten to overthrow the incumbent leadership.

Even though there is no doubt that the anti-corruption campaign is used as a political weapon to eliminate enemies of Xi Jinping, the CCP also has a genuine collective interest in fighting corruption since it threatens its control over society and erodes its legitimacy and authority, as explained above (see Lu – Lorentzen 2016 on the actual networks of corruption and the patterns of punishment). Nevertheless, the market economy brings strong tensions in a society controlled by the CCP. On the one hand, communist leaders at different levels of the hierarchy are asked to promote economic growth. On the other hand, they are required to behave ascetically. In a nutshell, they are asked to behave like communist monks handling a large wealth-making machine. This is not impossible. Parts of the Catholic Church, the Greek Orthodox Church, Muslim or Buddhist communities behave that way. Nevertheless, the stronger the requirements on ascetism, the stronger will be the temptation to break the rules and to use one's political power for personal enrichment. The emergence of corruption seems difficult to stop if party cadres and government officials are not given sufficient official and legal economic incentive payments, in other words as long as they are not paid higher wages discouraging them from taking bribes. As long as these incentives are legal and transparent, this can reduce the temptation for corruption. So far, the Xi Jinping leadership seems not to have chosen that route, but has instead decided not only to crack down on corruption, but also to take away many of the perks of office of communist leaders (banquets, service cars, size of offices and dwellings, travel facilities, etc.) and impose harsher conditions on their lifestyle, in a way that is reminiscent of Maoist times. These measures are undoubtedly likely to dull incentives to take initiatives to increase economic growth. The non-transparent cracking down on officials is also likely to paralyze decision-making of communist cadres, possibly costing the Chinese economy several percentage points of growth per year. On the other hand, the anti-corruption campaign is very popular among the Chinese public.

4.3. The growth of the private sector

The third development that threatens the party's control over the society in relation to market development is the growth of the private sector. As the private sector gets larger, private wealth accumulates, allowing private business networks to

act independently from the CCP, potentially even using this wealth as leverage on the party. So far, the answer of the CCP to this challenge has been twofold. A first response has been to strengthen party units inside the private sector. The Party's leading role has no boundaries inside Chinese society, so if the party secretary in a private enterprise gives suggestions to the business owner, the latter will see them as orders. This means that in China the boundaries between state sector and private sector are not as clear-cut as in other countries. The CCP has thus a direct influence over the private sector. The second response has been to co-opt successful entrepreneurs in the CCP. This means that the party secretary inside a private enterprise is often the business owner. This gives even more control to the CCP inside the private sector. The strategy of co-opting the private sector has been developed by Jiang Zemin when he was the General Secretary, based on the theory of the "Three Represents". Xi Jinping is less favorable to that strategy and wants to set a limit to the size of the private sector by keeping the size of the state sector large enough.

5. THE STABILITY OF THE CHINESE POLITICAL SYSTEM

How stable will the Chinese political system be given its hybrid nature (capitalist economy under communist leadership)? It is not easy to answer that question satisfactorily, but overall there are many reasons to believe that the Chinese political system can and will remain stable.

5.1. Reasons for stability of the Chinese political system

To repeat, the great gamble made by the CCP under Deng was that the CCP would stay in power if 1) the Chinese economy could achieve high growth rates, 2) challenges to the CCP's power can be fought off. China has been able to achieve high growth for 40 years. As we discuss below, its strategy for integration in the world economy should reasonably enable the Chinese economy from not falling behind the growth of the world economy. Assuming that this problem can be solved satisfactorily, what are the prospects for political stability?

A potential challenge could come either from a popular uprising or from an internal challenge from within the CCP. There is little chance, in my view, of an external challenge, either in the form of an external aggression or of very strong external pressure. Given the size of the country, this would seem very unlikely. A serious trade war started by the US could hurt the Chinese economy, like the rest of the world, but it is not clear at all that this could destabilize China's

political system. Any external aggression would probably tend instead to mobilize and unite the population behind its leaders.

Popular uprisings happen unpredictably, be it the Arab Spring or the June 4 movement in China.³ They are usually the result of a shock such as arbitrary behavior by government officials, a shock to the environment or to the economy, but most often these shocks do not lead to widespread collective action. In China, local revolts are very frequent, in particular in response to expropriation of peasants by local government for real estate development projects, but these local protests in the past nearly never spread to the national level. In the unlikely event of a popular uprising in China, its consequences would be far from clear. There is no organized opposition to the power of the CCP that would be able to seize power in a country the size of China. An internal challenge to the power of the CCP is thus not very likely.

There are other factors that contribute to the political stability of the current political regime. China's meritocratic administrative system leads to the promotion of the most competent leaders. This has guaranteed in the last few decades a very high quality of leadership, a clear advantage to secure political stability.

Another important factor of stability has to do with the Leninist rules used inside the CCP. The principle of democratic centralism, explained in section 2, maintains party unity and minimizes the dangers of political schism, as factions are not allowed to be formed inside the party. It is important to distinguish here between *fractions*, as exist in most democratic parties, and *factions* inside the CCP. The fractions often mentioned in the literature (see e.g. Nathan 1973) are not fractions in the traditional sense, because they do not promote a specific political platform or meet outside the party organs to determine such platforms. Fractions are mostly networks that act essentially as promotion machines. New research by Francois et al. (2017) shows both theoretically and empirically how they function. Entering a faction gives party members chances at a promotion because support from higher up is necessary to be promoted and those higher up tend to support promotion of party members from their own faction. This support is, however, limited. A member of a given faction at rank x in the hierarchy will not support promotion of a member of the same faction at the directly lower rank to rank x since that would limit his or her own chance of promotion later on. This rational behavior can be shown to lead to a stable equilibrium where none of the factions becomes too large. This is a system that emerged spontaneously based on individual rationality, but that contributes to stability inside the CCP.

³ The Tiananmen Square protests of 1989 are commonly known in China as the June Fourth Incident. (Editor's note.)

One of the two best-known factions inside the CCP is the Communist Youth League. Well-known leaders from that faction included or include Hu Yaobang, Hu Jintao, Li Keqiang and Hu Chunhua. The other faction is the Shanghai group. Jiang Zemin and Zhu Rongji were prominent leaders of the Shanghai group. In today's Politburo Standing Committee, Li Keqiang (Prime Minister) and Wang Yang, Chairman of the Chinese People's Political Consultative Conference are clear members of the Communist Youth League faction. Han Zheng, the former Mayor of Shanghai and Vice Premier of the State Council is a clear member of the Shanghai faction. Some people have argued that there is also a princeling faction to which Xi Jinping belongs, but others have argued that he was promoted mostly thanks to the Shanghai faction. Wang Huning, responsible for ideology, has close links to the Communist Youth League, the Shanghai faction and also to Xi Jinping himself.

5.2. The three tasks of political power structure

Despite the tensions inherent to having a market economy under the leadership and control of the Communist Party, one should not underestimate the stability of the Chinese political system. The main tasks of the power structure are not challenged. Finer (1997) lists the following three main problems every type of political system must solve: 1) the *succession problem* of political leaders, i.e. how a leader is chosen to succeed the previous one; 2) the *informational problem*, i.e. how leaders receive accurate information from their administration when many of their subordinates have an incentive to distort or hide information; 3) *generating tax revenues*. The Chinese political system had found ways to solve these three major tasks in a rather efficient way.

The succession problem is a fundamental one in all political regimes. In a democracy, this is solved *via* elections, but in autocracies every succession can lead to a major political crisis, unless there are well-accepted and credible rules of succession. In China, this has been the case since the end of the Cultural Revolution. The most important rule is the mandatory retirement at age 65 for members of the Central Committee and 68 is the maximum age for nomination to the Politburo's Standing Committee (PSC), the real power center in China. This retirement rule creates automatic turnover. The advantage is that less competent leaders do not stay too long in power. The disadvantage is that very talented leaders have to retire sooner than might be good for the interest of the country. The retirement rule also reduces the number of candidates for a top position in China. Indeed, it is rare to be appointed to the Central Committee before the age of 50. The age interval between 50 and 68 significantly reduces the number of candidates for top

jobs. Another rule that has mostly been tacit so far is that the current secretary general chooses not his successor, but his successor's successor. Thus, Hu Jintao is said to have been selected by Deng, whereas Jiang Zemin is said to have chosen Xi as Hu's successor, and Hu Chunhua, party secretary of Guangdong province, is said to be the successor of Xi Jinping chosen by Hu Jintao.

This is all quite subtle and interesting, in terms of originality of succession rules. The big problem in China is: how much commitment is there to these succession rules? Wang Qishan retired from the PSC after having reached the maximum age, but there is much speculation that Xi Jinping will use the powers he has concentrated to change the succession rules and bend them in his favor. There are already two bad signals suggesting that there is no commitment from Xi Jinping to the pre-existing succession rules. The first one is that at the 19th Congress of the CCP, Hu Chunhua and Chen Min'er, designated by Hu Jintao to become General Secretary and Prime Minister, respectively, after Xi Jinping's two mandates as Paramount leader, were *not* chosen to be part of the PSC. Future leaders are supposed to acquire some experience in the inner sanctum of power – i.e. are expected to have some PSC experience first. The absence of these designated successors from the PSC suggests that Xi will probably decide himself who will be his successors, or, worse, will stay longer in power than two mandates. Rumors have circulated that Xi does not like the existing succession rule, because it makes him somewhat of a lame duck in his second mandate. The second signal, admittedly worse than the first one, was the decision to abandon term limits for President of the Republic early in 2018. This came as a very big shock inside the very high levels of the party, but also more broadly among Chinese intellectuals and also among China observers. This move suggests that Xi may decide to stay on as paramount leader for more than the usual two terms (10 years). In that case, the succession rules of the past decades would seem to be eliminated, because of lack of commitment. It is too early to say that this is the case; one cannot exclude that these rules may be improved, but the evidence so far makes this unlikely.

We could thus end up in a situation where Xi Jinping hangs on to power for a sufficiently long period, eliminates the collective decision-making mechanisms (with unanimity rule inside the PSC), and starts abusing power more and more. Very often autocratic leaders hang on to power because they have made too many enemies and are afraid of possible backlash against them once they lose power. In that case, the succession is likely to be very chaotic and destabilizing for the regime. Again, it is too early to say how much of the succession rules Xi Jinping will end up throwing overboard, but what is happening in China shows that commitment to succession rules in an autocracy is not easy to enforce.

The informational problem is an important one in China, and it is related to incentives of cadres within the CCP to accurately relay information or not to the higher levels of the hierarchy. Given that it is an autocracy, the party does control all means of information. There is hardly any major source of information outside the control of the CCP's propaganda machine. Despite the troubling recent appearance of fake news in advanced democracies, many of which are generated by Russia's autocratic regime, independent media remain a reliable source of information, both for the general public and for political leaders. In China, however, there are no independent media. Top party leaders have always relied on vertical channels of information created and maintained by the Party. Indeed, at all levels of the Party, units constantly send reports up the hierarchy keeping top leaders relatively well-informed of what is going on in China. These vertical channels have, however, severely failed at critical times. The best known example is that of the Great Leap Forward, where leaders were afraid to report to Mao the extent of the famine, but were instead sending false reports on output increases to try to win Mao's favors, or to avoid his wrath. Indeed, as they found out the hard way, incentive problems have, especially at critical times, prevented information to flow correctly along the vertical channels. Communist leaders have learned lessons from these failures and rely also on alternative sources of information: tolerance of local protests which give information on management decisions of local leaders, voting results (percentage of approval for Party candidates) for local elections, protection of whistleblowers (like in the SARS case⁴), tolerance of partially free speech on social media, etc. One can safely conclude that today Chinese Communist leaders are quite well informed, which enables them to avoid making wrong decisions.

Taxation and state capacity are not a problem in China's communist regime. Significant state ownership gives direct control over resources. The government can indeed afford to charge low tax rates as it commands large control over resources of the large state sector (Gordon – Li 2005). This makes it possible to support low tax rates, which has good effects both on private sector incentives and on reducing incentives to hide in the informal sector. Moreover, the CCP has the additional instrument of party mobilization, which can at times mobilize resources and people, be it in case of a natural catastrophe or in case of war. Mobilization and campaigns are standard instruments of the CCP that can be used in exceptional circumstances. Most democracies do not have that tool.

⁴ In November 2002, an outbreak of what is believed to be severe acute respiratory syndrome (SARS) began in the Guangdong province of China. The government notified the World Health Organization (WHO) about this outbreak only in February 2003. (Editor's note.)

5.3. How likely is China to democratize?

As stated above, despite radically transforming its economy into a market economy, China did not democratize and its communist political regime has instead been reinforced. Is this likely to be a long run trend or should we expect China to democratize in the near or medium future?

The argument in favor of a future democratization is based on modernization theory. Formulated initially by Lipset (1959), this theory states that income growth should eventually lead to democratization. There is a huge literature in political science on modernization theory. In the 80s and 90s, most experts, including myself, expected that political reform would follow economic reforms, as China was growing at 10% a year. Deng Xiaoping supported economic reforms but never supported democratization in China. He initiated repression against the wall of democracy (1979)⁵ and the June 4 movement, already mentioned above. There was indeed the fear among Chinese leaders around Deng that even a slight democratization of the regime, like under Gorbachev in USSR, could lead to the implosion of the power of the CCP. Chinese leaders studied carefully the Gorbachev experience and concluded instead that the leading role of the CCP should be reinforced, which is the official view under Xi Jinping.

In Gorodnichenko – Roland (2012), we argue that modernization theory is not as powerful as one may have thought and that culture can play a role, on top of income dynamics, in affecting democratization. Countries with a collectivist culture are less likely to democratize, as they may, with a significant probability, establish regimes with a “good” autocrat without revolting against it, leading to stable and efficient autocracy. This cultural theory of democratization, which has solid empirical support, seems to fit what we are seeing in China as this “efficient autocracy” has pulled hundreds of millions of people out of poverty.

6. THE CHALLENGES OF INTERNATIONAL COEXISTENCE WITH CHINA

Given the miraculous growth China has experienced over the last 40 years, it has become impossible to ignore China’s role in the world and in Asia. China will in the foreseeable future become the country with the largest GDP in the world,

⁵ Between November 1978 and December 1979, thousands of people put up big character posters on a long brick wall of Xidan Street, Xicheng District of Beijing, to protest about the political and social issues of China. Under acquiescence of the Chinese government, other kinds of protest activities, such as unofficial journals, petitions, and demonstrations, were also soon spreading out in major cities of China (Editor’s note).

overtaking the US. China's population of nearly 1.4 billion people by far outstrips the population of any other country except India. In order to understand directions the international order is taking, one cannot ignore China. The difficulty in this endeavor is that China has a Communist regime and a thriving market economy, a combination that has never been observed so far.

The existence of democracies is obviously a challenge to CCP power, since democracies have a record of human rights and freedom that does not exist in China, but communist China also represents a challenge to the outside world. Many people fear that China's political regime may spread to other countries.

Other communist regimes collapsed because their socialist central planning system proved to be economically inferior to capitalism. Capitalism under CCP power continues to face a similar challenge. As long as catching up with the West takes place, CCP power should, in my view, be stable with very high probability. If China starts lagging behind growth of the world economy, the CCP will face a big legitimacy problem. This is the foundation of the fear of low growth among Chinese leaders. Chinese integration in the world economy is necessary to maintain growth and prevent economic "falling behind". This may or may not succeed.

One must keep in mind that the main objective of Chinese leaders is to keep the communist party in power. This was already the reason for the economic reforms in 1978. Deng Xiaoping thought that without major market reforms bringing growth, the CCP was doomed. He was right because this was the fate of communist regimes in Eastern Europe. Maintaining the CCP in power is also the reason for China's rapid and successful integration in the world economy and for recent initiatives like the Belt and Road Initiative (BRI). China's leaders feel that if the Chinese economy does not grow as fast as the world economy, they will be blamed for it, possibly leading to an implosion of the communist regime, like in Eastern Europe. Integration in the world economy therefore has this objective in mind. Access to world markets is thus crucial for Chinese leaders.

China, as a market economy, has become very dependent on the world economy for its growth. The legitimation of the regime is based on its high growth record relative to the rest of the world, but this growth record itself is based on export-led growth, as was the case with all Asian tigers. China's regime survival thus depends strongly on successful integration in the world economy. Without competition from the world economy, Chinese economic dynamism would likely fade away and the state sector might take again the dominant role in the economy.

In contrast to 20th century communism, China needs strong integration in the world economy. Differences in cultures and political regime with the rest of the world, and especially with advanced Western democracies, will nevertheless undoubtedly lead to frictions that must be managed peacefully. This is what we discuss in this section.

What are China's hegemonic objectives in the current world? It is very important to have an accurate answer to that question.

First of all, in terms of ambitions of territorial expansion, Chinese leaders have expressed the open goal of bringing Hong Kong and Taiwan into the mold of communist rule. It is happening in Hong Kong already. It is not clear how it will happen with Taiwan, but the Chinese leaders are patient. Apart from Hong Kong and Taiwan, China does not have ambitions of territorial expansion. It is important to know that a Communist regime has a higher cost of territorial expansion compared to other political regimes. This is because for Chinese Communists, taking control of a territory implies the need to establish comprehensive CCP control over that territory, which takes time and is relatively costly. British colonialists for example never tried to have comprehensive control over their colonial territories.

It is also important to know that China is not interested in the expansion of communist regimes worldwide, which was a clear objective of various Communist Internationals in the 20th century and also an objective of Mao Zedong. China is not doing any propaganda in favor of communism in foreign countries, in contrast to the Maoist years where it was very active. This is because communist ideology is dead, following the failure of socialist economies. As I argued above, inside China, communist ideology is only used formally, mainly in order to justify existing policies, not at all as a future-oriented eschatology, as was the case in the past by true believers of communism. Chinese leaders do not really believe in communist ideology, but they firmly believe in the goal of maintaining the CCP in power in China.

The absence of large territorial ambitions does not mean that China's growth will not lead to some forms of international instability. As it becomes more powerful economically and militarily, China will undoubtedly prove more aggressive in Asia, whether it is about borders in the South China Sea, territorial disputes with Japan, India, Vietnam and other neighboring countries.

If we believe current trends, China will also in the future be more aggressive in other domains: censorship beyond its borders (the Cambridge University Press episode being a good example⁶), retaliation against what the Chinese leaders perceive as "anti-Chinese" actions. Lacking the soft power of democracies and not even trying hard to do propaganda for their own system outside China, Chinese leaders will resort more and more to threats and blackmail in order to silence criticism abroad of China's denial of Human Rights to its citizens.

⁶ In August, 2017 the UK publisher agreed to suppress access to hundreds of its own articles that dealt with subjects sensitive to the Chinese authorities, such as those about the Tiananmen Square massacre. (Editor's note.)

Because of their China-centered view of the world, Chinese leaders will not try to take leadership of the international order, but instead claim stronger influence in international organizations proportional to China's economic and demographic power. Chinese leaders accept the existing multilateral international order because it brings more stability, which is to China's advantage. Given its size and the importance of international integration for regime survival (China's openness ratio is above 40%, whereas that of the US is below 30%), China cares a lot about the stability of the international order.

It would be, however, wrong to see China as one of the main defenders of the world order. China will tend to only pay lip service to international rules and decisions that go against its interest, but it is not the only country in that case. In the case of China, since CCP leaders view the right to self-determination as the highest principle in international relations, one should not expect them to invest too much in the international order or even try to shape the world in the direction of more multilateralism.

The long run coexistence of the Chinese communist regime and advanced democracies will be an important challenge in the future because of few shared values between these different regimes. Nevertheless, peaceful coexistence is in my view clearly possible, albeit with frictions, but it is also necessary. There is no realistic alternative. Therefore, peaceful coexistence with China should be an important goal for the international community.

The main challenge for the West is to better understand the nature of CCP power, understand its stability as well as its objectives. Mistakes can unnecessarily increase international tension. This would be the case for example if one thinks that CCP power can be overthrown through outside political pressure. Misreading China's international economic initiatives for political expansionism would also be tragically misguided.

The Trump administration has expressed the misguided will to sabotage the "China 2025" program and the drive towards high-tech innovation. This is pure bullying since, as explained above, while China's moves to reduce the income and innovation gap with the West are beneficial for the world economy, there is little chance that China will overtake the US in terms of fundamental innovation.

Before the Trump administration, the Obama administration had made moves to try to isolate China from other Asian countries. The Trans-Pacific Partnership (TPP) could clearly be understood that way. The US government has always blocked moves to increase China's role in international organizations, be it China's representation inside the IMF or the refusal of the US government to participate in the Asian Infrastructure Investment Bank.

The biggest obstacle to coexistence with China is not so much related to trade, which is beneficial to the whole world, but to foreign direct investment, in par-

ticular acquisition of foreign firms. On the Chinese side, there has been the fear that further economic opening will lead to loss of control of the party over large sectors of the economy such as in banking, internet and social media. On the other side, there have been fears that acquisitions of US firms by Chinese investors may be used for political control by the CCP, and therefore that one should block takeovers by Chinese firms. This fear is also widely shared in Europe as was observed for example in Germany with the takeovers of Kuka and Cotesa by Chinese firms that were heavily scrutinized before receiving the green light. This is likely to be a bone of contention for quite a while, independently of Trump's trade war against China (and the rest of the world). Even if relations between China and the international community improve, it is unlikely that trust building will be sufficiently strong so as to remove concerns about the possibility of using takeovers as a form of political leverage. There are, however, many other ways China can invest outside its borders without raising the specter of the danger of political leverage. This is the case for greenfield investment and also for infrastructure investment. Both types of investment may increase China's influence, but do not contribute to diminish national sovereignty over existing firms, and therefore should raise less concern. As for infrastructure, once it is in place, it cannot be used for political blackmail, because it falls under the control of national governments wherever it is situated. Even when it comes to acquisitions, a country can use it for political leverage only if its control over foreign firms is sufficiently large. This means that, on both sides, there is clearly room for takeover activity as long as foreign control remains sufficiently limited. The Chinese seem to have understood that they can tolerate more presence of foreign capital, for example in the banking sector, without feeling that their national sovereignty is threatened.

A major source of misunderstandings is due to differences in political regime between democracy and communism. On the Chinese side, protests about human rights violation should not be interpreted as signs of US expansionism. In a democracy, the press is free and cannot be censored. Criticism of government is not perceived as weakness. Declarations by politicians on human rights violations serve as signal to domestic voters. Chinese government pressure cannot make such declarations go away. They will always be there and should not be misinterpreted. Disapproval of the Chinese communist regime by the US does not mean that the US and China cannot coexist peacefully. The US has lost taste for international adventures and foreign "state-building". The failure of the Iraq war showed then clearly the weakness of the US superpower whose decline has been accelerating with the Trump presidency.

7. CONCLUDING REMARKS

In lieu of a conclusion, what are the reasons to be pessimistic and optimistic about coexistence between the US and China in the 21st century?

On the optimistic side:

- 1) Chinese leaders have a high level of competence due to the meritocratic promotion system. The economic team in China is particularly competent. Governor Zhou Xiaochan of the People's Bank of China between 2002 and 2018 was very competent, and so is his successor Yi Gang, as well as Guo Shuqing the Communist Party Chief in the PBoC, who is also its vice-governor.
- 2) There are many competent experts outside the current US administration expressing reasonable opinions about international relations with China.
- 3) The possibility of a trade war should encourage more Chinese direct investment in the US (different from acquisitions), which may partly mitigate negative effects of protectionism.
- 4) No irreversible mistake has yet been made on either side, but that may change soon.

On the pessimistic side:

- 1) Both the US and China put national sovereignty above the general interest of the planet. Nationalism on both sides is dangerous.
- 2) The current US presidency has been hijacked by populists and incompetent ideologues.
- 3) The Chinese president is weakened by the recent decision to abandon term limits and therefore needs to look strong outside China.
- 4) There is a limited understanding on the US side of the Chinese political regime as well as a limited understanding in China of the rest of the world.
- 5) There is not enough constructive dialogue between the two governments outside trade negotiations.

It is not clear which factors will weigh the most, the optimistic or the pessimistic ones. The important point though is that peaceful coexistence with China, a communist regime with a capitalist economy is both possible and necessary. There is every reason to believe that the Chinese regime will remain as it is and will continue to develop economically. Many tensions result from this coexist-

ence of different regimes, but it is by far not as bad as during the cold war, where there really was a systems competition to dominate the world. The whole world has adopted variants of the capitalist economy, apart from North Korea, but the political regimes of capitalist economies in the twenty first century remain very diverse and their relations should be managed optimally if we want to keep peace and prosperity, and not descend into the folly of nuclear destruction.

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