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The implications of change in the Chinese leadership on China's economic policy and EU-China economic relations

The upcoming change in the Chinese leadership attracts a major attention in Western countries. Many newspapers ponder whether he “is ready to break with the past”¹, “will he be different”², and most importantly - will he be a reformer³. These questions tell very little about China and a lot about West - they reveal that many people still tend to perceive China through the lens of their own countries' government models. Changes in Chinese leadership do not have the same significance as power shifts in the EU countries or the U.S., moreover the times of paramount leaders like Mao Zedong or Deng Xiaoping in China are over and a leader is only representative of a larger group.

Analysis from the perspective of “fifth generation of leaders”, “Xi-Li Administration” (*xili tizhi* - 习李体制) might bring better answers. New Chinese government will be in many aspects truly different from the “fourth generation of leaders”, but the difference does not lie in the leaders or political groups themselves, but rather in the fact that China is changing. In one of his speeches Xi Jinping said that all the reforms must meet social acceptance⁴. Changes in Chinese society influence the direction and pace of reforms. The overarching principle of reforms is still “crossing the river by touching the stones (*mozhe shitou guo he* - 摸着石头过河)⁵”.

Therefore, I think that a change in the Chinese leadership *per se* does not significantly impact the EU-China relations, the economic relations in particular. To understand how the EU-China economic relations may look like in near future it is better to analyze how the Chinese intellectuals perceive main problems that Chinese economy and society are facing. These problems are the “stones” that the Chinese leaders are touching while deciding on China's reforms. While the Chinese leadership decisions are made in a clandestine way, the Chinese most influential

¹ <http://www.economist.com/news/leaders/21565210-xi-jinping-will-soon-be-named-china%E2%80%99s-next-president-he-must-be-ready-break>

² <http://www.bbc.co.uk/news/world-asia-china-20338556>

³ <http://www.reuters.com/article/2012/11/06/us-china-politics-idUSBRE8A41LU20121106>

⁴ http://news.xinhuanet.com/politics/2013-01/01/c_114223419.htm

⁵ http://news.xinhuanet.com/politics/2013-01/01/c_114223419.htm

intellectuals are sharing their thoughts with general public. In the following passages I would like to present an outline of Chinese intellectuals ideas that are relevant from the perspective of EU-China economic relations.

The Pariahs of the New Right

Most Westerners associate economic reforms in China with the following: opening the market, protecting competition, removing non-tariff barriers to trade, taking anti-dumping measures, ensuring intellectual rights protection, privatization and stopping government subsidies⁶. All these ideas are supported by a group of intellectuals called the “New Right” (*xinyoupai* - 新右派). The leading figure in this group is Zhang Weiyong (张维迎), a famous Chinese economist, author of dual-track pricing reform⁷ and an ardent supporter of Austrian School of Economics⁸.

In the beginning of Reforms and Opening Up Period (*gaige kaifang*- 改革开放) neoliberal ideas were taken into account. One of the most influential leaders of PRC in the 1980s and 90’s Chen Yun (陈云) compared the Chinese economy to a bird in cage, where central planning is a ‘cage’ and economy is a ‘bird’⁹. Nevertheless, Chinese leaders were aware of catastrophic results of neoliberal transformation in Latin America’s countries and preferred a transformation model closer to the CEE countries, a model favored by Zhao Ziyang (赵紫阳) among others¹⁰.

China’s entry to WTO might have given a false impression that China could follow neoliberal economics guidance, which is the foundation of modern WTO principles. Several liberal reforms were implemented during the times when Zhu Rongji (朱镕基) was the Prime Minister (1998-2003), notably opening of the market and a small-scale privatization of SME (*zhuada fangxiao* - 抓大放小). Nevertheless, the New Right school of thought never gained the upper hand in Chinese politics. Some of the neoliberal reforms were necessary for the Chinese economy, some of them were implemented or were promised to be implemented in order to meet the WTO entry requirements. Although Jiang Zemin and Zhu Rongji were liberalizing to some extent Chinese economy the basic principles of state control were never rejected. Deng urged Jiang that: “no matter what, the government should have complete control of the financial system (...) inflation would

⁶ H. Zhao, [The present EU-China relations characteristics and prospects] 当前中欧关系的特点及其前景, 2009 www.aisixiang.com/data/25262.html.

⁷ J. Sachs, *Economies in Transition: Comparing Asia and Europe*, Massachusetts Institute of Technology 1997, p. 20.

⁸ M. Leonard, *What Does China Think*, London 2008

⁹ W. Zhang, *Transforming China: Economic Reform and its Political Implications*, Palgrave Macmillan 2000, p.

33.

¹⁰ *Ibidem*, p. 31.

bring major losses to the people”¹¹, and that public ownership should dominate China’s economy¹². Severe restrictions on bank credit and fixed asset investment were further highlighted in the “16 Points for Macro-Controls” (*dishiliu zhang hongguan jingji zhengce* - 第十六章宏观经济政策). Even during the most liberal times in Chinese economic transition, the New Right postulates were not implemented on a broader scale.

The other side of economic debate - the New Left (新左派)¹³ - is far stronger than the New Right, and it is getting more popular¹⁴. However it is not the mainstream of Chinese economic thought. Its supporters emphasize certain social problems that China is dealing with: Wang Shaoguang (王紹光) focus on the healthcare system, Cui Zhiyuan (崔之元) on workers position in the companies and negative sides of privatization. Another leading member of the New Left, Wang Hui (汪暉), states that China is between a crony capitalism and misguided socialism and that it suffers from the worst elements of both systems¹⁵. They state that domestic consumption, which is a high concern of Chinese politicians now, will rise when citizens will feel more secure about their future, mainly their health and their pensions¹⁶. When Hu Jintao became general secretary, many of the issues raised by the New Left, especially those connected with social justice and criticism of the free market, had been implemented into government program¹⁷. Now, almost all the other concerns of the New Left: healthcare, education, workers situation, environmental protection, were raised by Xi Jinping during one of his speeches¹⁸.

The New Right and the New Left stand on the opposite positions in the debate on Chinese economy. Neither is dominating, but it is clear that the ideas of New Left are closer to the current China’s model of economic transition. Chinese leaders understand that implementing neoliberal policies, ‘reforms’ in the Western sense of this word most, will not benefit their country for several reasons:

- a) Chinese companies are not ready for the competition on the global market. There is no such thing as a global level playing field. A full opening of Chinese market would profit the Western companies mostly, and that is why China prefers to choose equal or weaker partners, e.g. ASEAN–

¹¹ R. Kuhn, *How China’s Leaders Think: The inside story of China’s reform and what this means for the future*, Singapore 2010, p. 87.

¹² *Ibidem*, p. 99.

¹³ It is worth noticing that some of the New Left members do not accept this label, mainly because it is a Western term with distinct set of connotations and it is doubtful whether it reflects the nature of this group of intellectuals properly.

¹⁴ M. Leonard, *What Does China Think*, London 2008, p. 46.

¹⁵ W. Zhang, *Transforming China: Economic Reform and its Political Implications*, Palgrave Macmillan 2000, p. 33.

¹⁶ *Ibidem*, p. 38.

¹⁷ ed. J. Wong, H. Lai, *China into the Hu-Wen Era: Policy Initiatives and Challenges*, Singapore 2006, p. 97-98.

¹⁸ J. Xi, [Lecture during the meeting of members of Standing Committee] 在常委见面会上的讲话, 15.11.2012, <http://news.sina.com.cn/c/2012-11-15/121925587435.shtml>

China Free Trade Area¹⁹. Until Chinese companies get stronger, China will most probably continue to subsidize certain industries and maintain trade barriers. Free trade policies rarely if ever helped in early stages of economic development²⁰.

- b) Protecting intellectual rights might constrain creativity and business development of Chinese enterprises. When China will take a lead in R&D, then it will take steps to strengthen IPR enforcement. Among global top 1,400 by R&D spending only 9 are from China and 1,363 from high-income countries²¹. So, there is still a long way to go for China.
- c) Privatization not necessarily increases company's performance²². More important is to harden the budget constrains, improve corporate governance and ensure competition. These tasks are carried out by State-owned Assets Supervision and Administration Commission (*Guowuyuan guoyou zichan jiandu guanli weiyuanhui* - 国务院国有资产监督管理委员会). Most probably, State-Owned Enterprises will still play an important role in Chinese economy.

Many people assume that if one rejects communist-style central planning then one must espouse neoliberal economy²³, but it is not the case of China. This country is following its own path and it is unlikely that it will willingly bend to certain neoliberal rules of international trade soon²⁴. The path that China is following is serving it well and implementing neoliberal economy in China might actually lead to serious negative consequences. Many of the actions typically associated with “reforms” in the West might not be beneficial to China. For the benefit of EU-China economic relations it is necessary to realize that China is following its own transformation path. Nevertheless, many people still tend to believe that further unconstrained liberalization of Chinese economy, stopping subsidizing certain industries, large scale-privatization etc. will benefit the Chinese economy - they are called by Prof. Ha Joon-Chang “the Bad Samaritans”, who want to help but make things worse. Realizing that China benefits from the economic path it is taking is crucial for conducting further trade dialogues. Even though Western media might promote New Right intellectuals²⁵, their position in China is still relatively weak. They were and still are pariahs in China.

¹⁹ ed. J. Wong, H. Lai, China into the Hu-Wen Era: Policy Initiatives and Challenges, Singapore 2006, p. 556.

²⁰ H. Chang, 23 Things They Don't Tell You About Capitalism, London 2010, p. 111.

²¹ P. Nolan, Is China Buying The World, Cambridge 2012, p. 67.

²² ed. L. Sun, Ownership and Governance of Enterprises: Recent Innovative Developments, Palgrave Macmillan 2003, p. 29.

²³ R. Kuhn, How China's Leaders Think: The inside story of China's reform and what this means for the future, Singapore 2010, p. 14.

²⁴ W. Zhang, Transforming China: Economic Reform and its Political Implications, Palgrave Macmillan 2000, p.

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²⁵ <http://online.wsj.com/article/SB10000872396390444032404578010552215377098.html>

Second Reform?

One of the focal points of current policy discussion is whether China needs a second reform (*dierci gaige* - 第二次改革). The main supporter of this thesis is professor Chi Fulin (迟福林), the Deputy Director of the China Institute for Reform and Development (*Gaige fazhan yanjiu yuan*- 改革发展研究院). He states that because of changes in the Chinese economy and the impact of Global Financial Crisis the current export-oriented economy and reliance on FDI could not provide stimulus for rapid growth any more. China should invest abroad and develop domestic consumption²⁶. This view is also supported by Prof. Yu Yongding from the New Economic Thinking Institute²⁷ and Zhou Huilai²⁸.

Chi Fulin also mentions that China has put country wealth at the first place and ignored needs of the people. This resulted in high national income distribution disparity, reaching the Gini coefficient of 0,61²⁹. Therefore, China should decide whether it gives priority the state or the people (*guofu youxian, haishi minfu youxian* - 国富优先, 还是民富优先)³⁰. This postulate of Chi Fulin might actually be fulfilled in some extent. Xi Jinping notably returned to the Jiang Zemin's slogan of 'well-off society' (*xiaokang shehui* - 小康社会), which he mentioned in one of his speeches³¹. During the Hu-Wen administration this slogan was replaced by harmonious society (*hexie shehui* - 和谐社会) - the emphasis was put on harmonious growth, not on the financial well-being of each and every Chinese household.

Regardless of the need of certain changes it is unlikely that China will announce a second reforms. The *Gaige Kaifang* process was uneven from the beginning³² - the Jiang-Zhu administration was centered on growth and allowed liberalization of the market, the Hu-Wen administration promoted balanced development³³. Nevertheless, the *Gaige Kaifang* process is perceived as a single process that might have many faces. In the words of Xi Jinping it is a long and complicated process that need to be carry on³⁴. Xi Jinping adds also that if other significant social

²⁶ FF. Chi, [Why launch the Second transformation and reform] 为什么提出第二次转型与改革
blog.china.com.cn/chifulin/art/3600944.html

²⁷ Y. Yu, Restructuring over growth [in:] ed. M. Leonard, China 3.0, ECFR 2012, p. 42-43.

²⁸ H. Zhou, [China's international relations in the perspective of Xi Jinping visit to the U.S.]
从习近平访美看中国外交, <http://www.aisixiang.com/data/50265.html>;

²⁹ <http://english.caixin.com/2012-12-10/100470648.html>

³⁰ F. Chi, [Why launch the Second transformation and reform] 为什么提出第二次转型与改革
blog.china.com.cn/chifulin/art/3600944.html

³¹ <http://www.chinanews.com/gn/2013/01-01/4452363.shtml>

1. ³² B. Góralczyk, [A Dragon's Awakening: China's return on the global scene] *Przebudzenie Smoka: Powrót Chin na scenę globalną*, Warszawa 2012, p. 123.

³³ ed. J. Wong, H. Lai, China into the Hu-Wen Era: Policy Initiatives and Challenges, Singapore 2006, p. 43.

³⁴ http://news.xinhuanet.com/politics/2013-01/01/c_114223419.htm

changes occur the *Gaige Kaifang* process needs to adapt to these changes³⁵. He is aware of the pitfalls of the current Chinese transition model, which is growth-oriented, based on export, relying on foreign investments and domestic cheap labour. Nevertheless, if any changes would be made to the current Chinese transition model they still be a part of the original *Gaige Kaifang* and not a second reform.

The Chinese Dream

From the EU-China economic relations perspective it is not only important what is China's economic policy, but also how China perceives its role in international relations. One of the chief characteristics of China policy thinking is a well-earned pride³⁶. In the eyes of Chinese politicians China is regaining the major place in the world, which it used to have for centuries. It now probably the only Civilization State (*wenmingxing guojia* - 文明型国家) which is characterized, in the words of Zhang Weiwei (张维为) by "super-large population, a super-sized territory, a super-long history and a super-rich culture"³⁷. Prof. Zhang Weiwei, a scholar from Fudan University and Geneva School of Diplomacy and International Relations is a leading defender of China's political and economic system and major supporter of the view that the rise of China will shape the world in 21st century and for centuries to come. He points out several reasons for the China's success: meritocracy political system as opposed to populist democracy; blended economy approach (*hunhe jingji* - 混合经济) combining invisible hand of the market with visible hand of the government; sequential differentiation (*shunxu chayi* - 顺序差异), reforming the countryside first, then the city, the coastal areas before inland areas, economy first, then the politics, all according to a traditional Chinese holistic thinking (*zhengti siwei* - 整体思维); last but not least a strong government as understood by Confucian tradition (*rujia qiangshi zhengfuguan* - 儒家强势政府观)³⁸.

Broadly speaking, Zhang Weiwei claims that Chinese model is for various reasons superior to the Western one, and as China develops it will create a new value, it will not become Western in political, cultural, economic or any other sense of this world. It is actually the West that could learn from China. This view is also supported by some Western intellectuals, e.g. Martin Jacques³⁹.

³⁵ http://news.xinhuanet.com/politics/2013-01/01/c_114223419.htm

³⁶ R. Kuhn, *How China's Leaders Think: The inside story of China's reform and what this means for the future*, Singapore 2010, p. 7.

³⁷ W. Zhang, *The World Financial Review*, <http://www.worldfinancialreview.com/?p=1626>

³⁸ W. Zhang, *The Analysis of a Miracle: The China Model and its Significance*, <http://cmp.hku.hk/2011/03/29/11205/>

³⁹ M. Jacques, *When China Rules the World: The Rise of the Middle Kingdom and the End of the Western World*, Penguin Group 2009, p. 428.

This approach to Chinese success, which is becoming a dominating one in China, raises serious concerns about the role of China in international politics and economy. Provided that it will continue to develop at a very fast pace, will China be a global player and a co-operative member at globalized forum or will it perceive itself as a country superior to all the others.

Conclusion: Future of EU-China Economic Relations

The change in the Chinese leadership by itself means very little for the EU-China relations. The government in China is a consensus-based one, and a single person cannot impact the path that China is taking. The shifts in the balance of power between different Chinese political groups: the Princelings (*taizidang* - 太子党) associated with Xi Jinping, Youth League Faction (*tuanpai* - 团派) associated with Li Keqiang, or the Shanghai-clique (*Shanghai bang* - 上海帮) gathered around Jiang Zemin, are less important than the structural changes in the Chinese society.

The current export-oriented transition model relying heavily on FDI and cheap labour force is facing serious difficulties like rising social inequality, environmental degradation, insufficient healthcare and education, etc. There is a need of change in the current *Gaige Kaifang* process, which could be called the Second Reform (Chi Fulin) or more probably only an adjustment as Xi Jinping speeches may suggest. "A rose by any other name would smell as sweet" - and would have a significant impact on EU-China economic relations as well.

The dominant view in Europe that an improved market access in China is the *sine qua non* for any future investment agreement⁴⁰ might not be an appropriate one. China must now improve domestic consumption and invest more broadly abroad, and neither of these goals would be achieved by increasing the number of FDI from Europe. Moreover, protectionism is clearly beneficial to the Chinese economy, because its companies are not ready yet to compete on a global market. Therefore, further opening of Chinese market, decreasing barriers to trade and subsidies for Chinese companies will most probably not happen any soon. Recent unsuccessful EU claims for China to give 30 percent of its market share to EU telecommunication suppliers and abandon "illegal government subsidies" for Huawei and ZTE illustrate the obstacles that EU might face in following the present economic policy towards China⁴¹. The first period of EU-China relations characterized by high exports and significant need for the Western FDI might be over.

⁴⁰ B. Gavin, China's Expanding Foreign Investment in Europe: New Policy Challenges for the EU, European Institute for Asian Studies 2012, p. 13.

⁴¹ http://europe.chinadaily.com.cn/business/2013-01/31/content_16191800.htm

China's rapid development also raise concerns about its role in the international politics and economy - will China be an equal partner and a co-operative member of international organizations or a nation-civilization feeling superior to others; will it be possible to negotiate with China on the WTO level which is now the preferred legal framework for EU-China trade relations⁴², or maybe bilateral agreements will be preferred⁴³.

Now EU should observe closely the changes that are happening in the Chinese society and economy, listen to the leading voices in the Chinese political debate and accordingly by feeling the stones cross the river towards equal and beneficial to both sides EU-China economic relations.

⁴² ed. F. Snyder, *The European Union and China, 1949-2008: Basic Documents and Commentary*, Oxford 2009, p. 55.

⁴³ B. Gavin, *China's Expanding Foreign Investment in Europe: New Policy Challenges for the EU*, European Institute for Asian Studies 2012, p. 11.

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