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### Report

**Original citation:**

Westad, O.A (2012) *China's geoeconomic strategy: China's international future*. IDEAS reports - special reports, Kitchen, Nicholas (ed.) SR012. LSE IDEAS, London School of Economics and Political Science, London, UK.

This version available at: <http://eprints.lse.ac.uk/44200/>

Originally available from [LSE IDEAS](#)

Available in LSE Research Online: June 2012

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# ➤ China's International Future

Odd Arne Westad

**O**ver the past two decades China has become integrated in the world economy to an extent unprecedented in the country's history. When foreign investment returned to China in the early 1990s, after the shocks of the Tiananmen events, it was at a pace and level never seen before. The combination of a dedicated and cheap workforce and the hope of buying into China's own domestic development led to the country leap-frogging all others in terms of foreign direct investment (FDI). Over the course of the whole decade China was second only to the United States in attracting FDI – a remarkable change, given that foreign investment of any kind had not existed in China prior to 1980. Up to today the changes in China's economic system have to a large extent been driven by the needs created by foreign investors. For instance, a legal framework of ownership had to be created to serve those who wanted to invest in China. The same framework could then serve China's own embryonic capitalists. Similarly for stock exchanges, insurance arrangements, and quality control. China's bid to join the World Trade Organisation (WTO), which finally succeeded in 2001 (very much thanks to the goodwill of the United States), was intended to serve China's export potential, but also made the country sign up to stringent regulations concerning state subsidies (or rather the absence thereof), industry standards, copyright protection, and not least opening the Chinese market to foreign competition. **The international drove the domestic in terms of economic change.**

By 2000 the socialist economy in China had lost out to a market economy encouraged by a party dictatorship that was still Communist in name. For China's population it was clear that they were living in a new society in which market forces were dominant. State-owned enterprises were sold off, downscaled, or allowed to go bankrupt (at least 5,000 such companies have gone bankrupt each year since 2000). Those that survived are publicly listed and under the same management regulations as all other Chinese companies. For ordinary people this rearrangement means that employers that may not have paid them much money, but otherwise looked after them and their children from the moment the state assigned them to the factory to the day they died, were now a thing of the past. No more free healthcare, kindergartens, schools, housing, holidays, or homes for the elderly. Instead, people had to – gingerly – enter a private housing market, search for a good job, and save for their children's college education. Millions of people had to travel elsewhere to find work. China's capitalism, when it finally broke through in the 1990s, was very unlike the European and the Japanese variants, with their safety nets and entitlements, but remarkably like that of the United States, with its emphasis on mobility, opportunity, and personal responsibility.

But it was not only the Chinese population that had to learn a new way of living in the 1990s and 2000s. The state had to learn, too. Having given up direct ownership of the economy, it had to create new instruments of indirect control, most of them borrowed whole-sale from the West and based on legislation, regulation, and fiscal and monetary policy. It was, in many ways, a return to China's preoccupations of the inter-war period, only with a much larger segment of the population involved in the industrial economy. Some critics called it a counter-revolution, since the state increasingly saw its main task as serving market-led economic growth.

By the 2000s the Chinese Communist state had adopted concerns about inflation, interest rates, credit flows, and property rights that sounded very similar to those of Reaganite America or Thatcherite Britain in the 1980s. Capitalism was in the driver's seat, even if CCP leaders would not admit it, and the role of the state in advanced capitalist economies – minus electoral democracy – was what Beijing was aiming for. China's capitalist revolution of the past twenty years has brought the country closer to the outside world – and especially to the United States – in terms of the aims many people set for themselves or how the Chinese state operates than ever before, or at least since the Mongol dynasties of the thirteenth century.

Why did the party do it? Founded on an anti-capitalist creed in a China in which many people – not only Communists – felt that capitalism had brought nothing but suffering, exploitation, and humiliation, the move from Maoism to market demanded a remarkable turn-around not just in ideology but also in mentality. For critics of the CCP inside and outside of China the answer is simple: the party's much lauded 'flexibility' was a consequence of its long history of manipulating the truth and deceiving those who believed in it. Party leaders embraced capitalism to enrich themselves and their families, and because the plans for the future they had once promoted had utterly failed. There is obviously some truth to these presuppositions, but they are far from the whole truth. The main reason why the CCP chose the market was that from the position of the early 1990s there seemed to be no other way out. Modernity was capitalist. The USSR had – very unexpectedly for the Chinese – collapsed, as had the socialist states in Eastern Europe. The United States led the way towards an increasingly integrated capitalist world economy, and those who opted out of it would fall behind. The risk of falling behind was what first and foremost animated China's leaders from Deng Xiaoping to Hu Jintao. If the race to modernise could be better run with Nike trainers, then the Chinese Communists would put them on (especially if the shoes themselves were made in China).

A new generation of returned students played a big role in China's capitalist transformation. Even though a very large number of Chinese who had studied abroad wanted to remain abroad in the 2000s, those who did go back to China had the expertise and the status to begin introducing new practices, first, in private enterprise, and, second, in the state and even in the party. By the late 2000s one could get the impression that the CCP itself had taken over many of the management methods of foreign enterprises: quantifiable results for young party brass were all the rage among the top cadres of the party. One high-level CCP member described his training at the party academies in terms that anyone with a MPA or MBA from Harvard or LSE would recognise. At the same time foreign educated academics are transforming China's own higher education. Research output is crucial to promotion, and the output is supposed to be of international standard. Student concerns are increasingly taken seriously by their professors (since they are paying customers). When party control and academic ambition collide, it is as often the latter that wins out as the former.

While consumer choice meant nothing in China before the late 1980s, it now means a lot to most Chinese, even those who live far from the main cities. The preoccupations are very similar to those of the pre-World War II era: how can modernity – preferably of an international kind – be best expressed in terms of products. Young people in China today are among the most fashion- and brand-conscious in the world. Foreign-produced goods generally have the edge, even though some Chinese brands are beginning to catch up. Music is often American, with liberal doses of Canto-pop thrown in. Clothes styles and hair styles are Western, mediated through Hong Kong and Taiwan. For other products, concerns such as environmentalism or sustainability are beginning to find their way in, but not on key issues that really matter to the Chinese consumer, such as buying a car. In China – the world's largest market for new cars in 2010 – the American habit of buying the biggest engine your pocketbook can afford is still the rule (with predictable consequences: China today has twenty of the thirty most polluted cities in the world).

At ground level, mass consumption is only one part of China's capitalist revolution. The other is the way people invest in the new economy. The main aim for many in China today is to buy their own house or apartment. In the cities it can only be done through immensely hard work by a young couple, since property prices are almost at European levels and salaries are much lower. Even though the Chinese savings rate is still very high, more and more of it – within an extended family – contributes in one way or the other to paying off debt. Meanwhile more and more young Chinese are investing directly into the market, and often find that with some sense added to the general expansion that the Chinese economy has gone through their investment can earn them as much as their salary. All put together, Chinese investors – in property and stock – are becoming increasingly numerous, and – even though they are not likely to be more democratic or less nationalistic than their fellow citizens – they have, quite literally, bought into a development pattern for China that is quite similar to that of Western nations, or Japan or South Korea.

The one area in which China stands out from other East Asian states, including Taiwan, in terms of development is – ironically enough, given the pretensions of its Communist government – the matter of equality. While the early Communists had dreamed about a China which was modern and strong and socially just – and Mao had pursued the topic of equality endlessly in his campaigns – China today is one of the most socially stratified societies on earth. While more than a third of the population – those who have not joined the industrial economy – live on slightly more than \$2 income per day, China has 128 dollar billionaires and half a million millionaires. Its Gini coefficient (the standard used for measuring levels of income inequality) is higher than that for any other country in its region, and just slightly lower than the most unequal countries on earth, such as Brazil. CCP leaders defend themselves by quoting Deng's maxim that some people have to get rich first, while presiding over increasing levels of inequality. Yet in some areas social unrest is rising, with local organisers claiming that the party is a tool of foreign exploitation of China. For minorities, in Tibet and Xinjiang but also in the south, the same party that tried to drown their identity

in blood during the Cultural Revolution, now drowns it in consumer products and market adjustments, while increased mobility leads to ever more Chinese in minority areas. Capitalism, though victorious in China, is in no way uncontested.

The most remarkable story of China's international development over the past thirty years has been its re-engagement with the rest of Asia. Three decades ago China suffered a self-imposed exile from the continent of which it is a part. Its only close relationship was with North Korea, and even there Beijing had to compete for position with Moscow. As if this diplomatic isolation was not enough, China had territorial issues with all of its neighbours (North Korea included). It was an Asian world that seemed to have expurgated China from its midst. The central kingdom was no longer central; it was distinctly peripheral to the rest of the continent.

While the main reason for China's marginality was its own contrary politics, another key reason could be found in the strong economic gains made by other Asian economies while China's own economy stagnated. Japan had of course been the pioneer of development in the region, with substantial growth rates even in the early 20<sup>th</sup> century. But from 1950 to 1973 the Japanese economy grew by an average of 10 percent per year, as did Taiwan. Singapore, South Korea, and Hong Kong all grew at 8 percent. In China GDP per capita in 1973 was around \$800. In Japan it was \$11,500, in Hong Kong \$7,000, in Singapore \$6,000, and in Taiwan \$4,000. China was falling further and further behind the leading economies in Asia, and even though most Asians would have liked to see China open up to their exports, they did not actually believe that it was going to happen at any point soon.

Compare this with the situation today. China's own economic growth since 1980 has been spectacular, averaging near 10 percent, and it has rejoined an integrated East Asian system of trade, finance, and investment. What is more, this growth has taken place in a country that has 1.3 billion people in it; more than double the population of the rest of East and Southeast Asia put together. The journey that China has been on over the past generation has been intimately linked with its relationship to its neighbours,

first those next-door and then into the Southern and Western parts of the continent. Indeed, China's rise would have been impossible without it revitalising these links. China is now an economic powerhouse that all of the rest of Asia orients itself towards, and its policies on all matters are of crucial importance for the whole region.

The development of China's economy will be at the center of the country's international affairs for the next generation, irrespective of the twists and turns in its domestic politics or its diplomacy. The reason for this is not only that China is now the second largest economy in the world, but the roles it has taken on for this to be possible. China is today the world's workshop, the zone where things are made which then end up on the shopping lists of Americans, Europeans, and Asians alike, and which nearly everyone else aspires to possess. This is the country's current role, and it has achieved it by being willing to play the global market game according to the rules that were set up first by Britain in the 19<sup>th</sup> century and then by the United States in the 20<sup>th</sup>. In spite of its government's nominal Communism, China has in practice become the champion of free market capitalism, internationally if not always internally. It is working hard to take on the rules of the game and is increasingly concerned that others, be it in Africa or Europe, are themselves not always doing so. Seen from a Western perspective it is hard not to conclude that China is now 'playing our game.'

But as China emerges as the master player of international capitalism, it is also obvious that the rules of the game are being re-made in China. In spite of observations by sceptics, these sinified rules so far rarely go in the direction of corporatism or state-control, but, at best, in the direction of collective decisions and compromise, and, at worst, in the direction of corruption and nepotism. It is very unclear how Chinese capitalism is going to influence practices in other countries, especially in cases where there are great cultural differences with China. Given the massive amount of foreign investment that has flowed into the country over the past decade it is a given that over time Chinese financial practices will influence the foreign companies that do business there. But at the moment the Chinese are busy implementing foreign

rules, for instance on managerial and labour relations, in ways that are profoundly changing Chinese society.

The Chinese government today wants to play a strong regulatory role in the development of the country's economy. Because China is a political dictatorship, all institutions, including private companies, pay generous attention to government instructions. But in reality the state's ability to influence private decision-making is limited, in spite of the repressive means at its disposal. In South Korea or Taiwan the regimes could set directions because they controlled credit and capital-flows, and because they – and only they – facilitated access to foreign markets. The amount of foreign direct investment in their industrialisation processes was miniscule, their credit companies were under state control, and their main firms invested nationally for export abroad. In China these crucial aspects of industrialisation are turned upside down. Foreign investment has driven significant parts of the process, foreign banks are operating in China and Chinese banks have plentiful means to resist government pressure, and the biggest Chinese companies have already become multinationals with large investments abroad. The domestic Chinese growth process since 1990 has not been governed by national priorities or five-year plans, but by the chaotic interplay of market forces. All of this has happened while the state has kept its investments in profitable industries, owning or part-owning many of China's biggest companies. But, as one economic planner told me recently, state-owned companies are increasingly behaving like privately-owned companies in the market; they recruit their managers from the same pool of talent and they are equally responsible for profits and losses. They may listen to what the government says, but only if it provides a sound bottom-line for their company.

At the moment quite a few global investors and corporate executives agree that China will re-invent global capitalism rather than ruin it. In the wake of the crisis of 2008/09, Chinese officials and businessmen alike began lecturing Western countries on the need for market and currency stability, and for avoiding corporate greed, bad loans, excessive deficits, and extravagant consumption. Some of this sounds laughable, given the amount of bad business practices



in China itself. But it does signal that many elite Chinese now see themselves as stakeholders in an international economic system, on the success of which their futures depend. Many people in China (and quite a few outside) dream about a future Sino-capitalism that will be better organised, more balanced, and less destructive than its Western inspirators. So far there is little that tells us that will be the case. But, as has often happened in the world economy before, those who are the generators of global growth innovate as well as imitate. Future Chinese leaderships, public and private, may be stimulated by the crises they have gone through to opt for more regulation and government design than we have seen in previous versions of world capitalism.

The 2008/09 global financial crisis also showed a China that had arrived as a key player in the world economy. At the World Economic Forum in Davos in 2010, Chinese Premier Wen Jiabao placed the blame for the crisis on the 'inappropriate' macroeconomic policies of Western countries 'and their unsustainable model of development characterised by prolonged low savings and high consumption; excessive expansion of financial institutions in a blind pursuit of profit; lack of self-discipline among financial institutions and rating agencies and the ensuing distortion of risk information and asset pricing; and the failure of financial supervision and regulation to keep up with financial innovations, which allowed the risks of financial derivatives to build and spread.' Quite a handful: the apprentice was taking the past masters to task for their excess. But the medicine the CCP itself prescribed did not imply that there was anything wrong with capitalism as such; instead it implemented the largest stimulus program of government spending in history, thereby attempting to stave off the worst consequences of the crisis for Chinese companies and for the Chinese population. Post-crisis growth for China will most likely not be of the same scale as before, because of international competition and, eventually, the country's aging population. But even with 'only' six percent annual growth on average, China will probably still become the world's largest economy sometime in the mid 2030s.

China's international position in the 21<sup>st</sup> century will be determined as much by what happens inside China as what happens outside its borders. The country's biggest domestic problem is that uneven growth has left large regions behind and that the lack of a proper welfare system and protection for workers against exploitation has led to an extremely high level of inequality. While Premier Wen and others are lambasting the West for its excesses, inequality in China is at least twice as high as in the United States or Britain, with higher ratios to relatively equal societies such as Germany or France. While slowly and uncertainly trying to deal with its worst consequences – for instance by re-introducing some forms of subsidised education and health care – the Chinese government is defending itself by continuing to make the argument that 'a rising tide lifts all boats'. The problem is that there are no signs that Chinese inequality is abating; on the contrary, the situation in the poorer regions is getting worse and worker unrest over low pay and atrocious working conditions in many factories is on the increase.

In spite of receiving credit for China's overall economic growth, there is little indication that the CCP as a party is capable of dealing with some of the social tensions this growth is creating. The party's steady refusal to allow increased political pluralism, which could have acted as a safety valve against discontent, will make Chinese politics more unsettled over time. The CCP today is unable to act with massive brutality against its own urban population, as it did during the Mao era, not least out of fear that such atrocities could unsettle the country's economy. A leading party member told me that he thought that even a repeat of 1989 would be unthinkable now – 'just imagine,' he said, what would happen to the country's credit rating!'. But at the same time the party's leaders gamble all on economic growth keeping their people from taking action against them. Such gambles rarely pay off.

A main reason why China is viewed with such suspicion abroad is that it is led by a Communist party. But today's Chinese regime is a far cry from Communists of the past. In reality, the regime itself has become much more like what Taiwan or South Korea were before democratisation – authoritarian, and sometimes ugly and brutal, but not capable of atrocities on the scale of those of the past, even in its own defence. While it is impossible to predict what will happen in Chinese politics, I would not be surprised if China follows a similar pattern of democratisation to the other main states in the region, only stretched out over a longer period of time. Whatever happens, the CCP will not be around forever, and those foreign observers who today equate the party with the country are making a major mistake: history shows that China is as capable of political change as it has recently been of economic and social change, and there is no set of engrained 'values' or 'attitudes' that will necessarily put the country at odds with its neighbours or with the West. As before in its history, China's direction will ultimately be a matter of its leaders' political choice. ■