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【Book Review】

Red-Hatted or Red-Blooded? Party Capitalism and the Choices for the Chinese Economy

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Jonathan Fenby. 2014. *Will China Dominate the 21st Century?* Cambridge, U.K., Polity Press. Pp. vii, 139. ISBN 978 0 7456 7927 3 (paperback).

Damien Ma and William Adams. 2014. *In Line Behind a Billion People: How Scarcity Will Define China's Ascent in the Next Decade*. Upper Saddle River, N.J., FT Press. ISBN 978 0 13 313389 9 (electronic).

Michael Pettis. 2013. *Avoiding the Fall: China's Economic Restructuring*. Washington, D.C., Carnegie Endowment for International Peace. Pp. viii, 170. ISBN 978 0 87003 408 4 (electronic).

Joe Zhang. 2014. *Inside China's Shadow Banking: The Next Subprime Crisis?* Honolulu, HI, Enrich Professional Publishing, Inc. Pp. ix, 178. ASIN: B00D8DKWWM (electronic).

朝の紅顔、夕べの白骨

As China has rocketed into the stratosphere of global economic rankings in recent decades, journalistic and academic accounts of the country's ascent have proliferated like so many eddies in its superheated plume. For a long time the tone of such works tended towards the laudatory, extending on occasion to something approaching awe. That tone has not yet disappeared entirely; traces of it, for example, are still detectable in the claims made about the China Development Bank by two financial journalists in the preface to their recent sketch of its rise to its current status as, allegedly, 'the world's most powerful bank.' The authors defend this judgment by asserting that the CDB has 'arguably…an even more impressive record' than the Federal Reserve in dealing with the 'Lehman shock', since it 'devised a system to fund local infrastructure projects that is credited with helping China sail through the global financial crisis while the United States and Europe stumbled' (Sanderson and Forsyth, 2013, p. ii). Yes, they concede, there may be a 'dark side' to the activities of the bank and its all-powerful chairman, Chen Yuan; within China itself a good part of the responsibility for problems of rising income inequality and a mass of potentially catastrophic bad debt may fairly be laid at the CDB's door (p. vii), but against this one must set success stories like that of Chery Auto, 'a perfect example of how CDB has helped transform China's economy and increased its competitiveness' (p. 176), and the immense influence that the CDB wields in Africa and Latin America today. Reform may be necessary, indeed unavoidable, but one does not sense from this account that there is a real crisis in the offing, since 'China has decent infrastructure and can afford to move to a more market-based system where consumption is better promoted and capital is freed up to follow the best, most innovative returns' (p. 180). At most an easy course correction may be advisable, but there seems to be few worries here about the economy maintaining its rate of climb.

For others, though, such confidence has always been much harder to sustain, and their ranks have recently begun to swell. According to one of their number, Michael Pettis, this reversal of mood among ground-based observers can be dated quite precisely.

> Although for many years the China skeptics were very much in the minority amid the sometimes gushing and largely ahistorical analysis provided by most experts and commentators on China, by early 2012 it had become increasingly obvious to most economists that the development model that had generated spectacular growth for the Chinese economy over the past three decades had reached its limits. (p. 3)

Quite why it should have been at this particular juncture that apprehension began to infect the majority is an interesting question in its own right, but for the moment it is enough to note that Pettis seems right to assert that the bulls have indeed been heading for the exit of the China shop over the past couple of years. And with the stampede gathering pace, the focus on the problems facing the managers of China Inc. has become much more intense and discussion of their performance far less guarded. The most serious factors now worrying those tracking China's trajectory include (in no particular order): the rapid approach of the 'Lewis point' and the consequences that must flow from the ending of China's 'demographic dividend' in the shape of labor shortages, rising wages and lost competitiveness; the looming prospect of an 'aging' society in which support for the vast increase in the population of the elderly in coming decades must devolve on the state, given how the resources of the family have been stretched to breaking point by the effects of a 'One Child Policy' now in its fourth decade; the enormous expansion of debt, both in the official banking sector and in the even more opaque world of 'shadow banking', particularly since the credit boom unleashed by the government to stave off the effects on employment of the 'Lehman shock'; the beginnings of a reversal of the unprecedented and seemingly inexorable rise in house prices which has been widely interpreted as constituting a bubble of dimensions equal to, or even greater than, the subprime blister that burst so painfully in the U.S.A. in 2008; and a tide of stories (one that shows no sign of ebbing) about waste, inefficiency, misallocation of resources and corruption that seems to presage a rerun of what was exposed to public view in Spain, Ireland and Greece after Lehman.

All of this has led to an apparent consensus about the need for a radical and sustained 'rebalancing' of China's economy that will see investment by the government replaced by private consumption as the main engine of economic growth. The first-stage 'development model' widely credited with propelling China onwards and upwards has now, it seems, exhausted its fuel and must fall away. But does this mean the end of state capitalism, the much vaunted system that is said to have rescued China (and the world) when the West's economies imploded in 2008? Will it simply have to be jettisoned as so much deadweight, leaving a proper market system to function as the country's chief propulsion unit? Unravelling the knots that make up this conundrum depends on finding answers to four separate questions. Is systemic economic change now simply unavoidable? What form must it take if it is to be effective? Is the dismantling of state capitalism, as a matter of both ideology and practice, politically feasible within the constraints of the current system? And if it is not, what will happen if it begins to act as a serious drag on economic growth and China fails to reach escape velocity?

On the issue of whether systemic change is now inescapable, the four works under review here share a common point of departure; the conviction that the economic arts widely extolled for providing China with loaves and fishes to date cannot continue to work seeming miracles henceforth. For Damien Ma and William Adams, '...dramatic change is not only necessary but also demands some urgency... [given that] none of the factors that fed the Panda Boom could last indefinitely...' (p. 271). Beyond dispute,

> Stasis is no longer an option. Collective recognition is growing among policymakers and political elites that the only way to alleviate the country's daunting economic and social malaise, as well as to ensure the resilience of the party-state itself, is once again to embrace change. (pp. 270–271)

Jonathan Fenby's wide-ranging survey of China's prospects in the decades ahead is equally forthright. He unequivocally endorses (pp. 53–61) ex-Prime Minister Wen Jiabao's 2007 pronouncement that the country's development path had become unsustainable, uncoordinated, unbalanced and unstable. These features were, in Fenby's judgment, the product of 'structural weaknesses in the economy' which must now take center stage, since 'Headlong growth masked these flaws as the 'China model' seemed all-triumphant; now they have to be addressed if the PRC is to continue to move forward' (p. 63).

Joe Zhang's concerns appear somewhat narrower, but they do not inspire a view of the future that is any more comforting; 'deeply worried about the negative real interest rates, and the parallel escalation of inflation and the credit explosion in the past three decades' in China (p. 89), he can foresee only two scenarios. In the 'nice' one the People's Bank of China embarks on a fundamental rebalancing by raising deposit and lending rates, thus benefitting the country's long-suffering savers at the expense of state-owned enterprises that have enjoyed the privilege of cheap capital for decades (one of the central pillars that has sustained the weight of state capitalism). True, this will lead to bankruptcies and rising unemployment, but the consequences of the other, 'nasty,' scenario in which the central bank continues with the strategy of the past, are far worse.

> A crisis will erupt in one of three possible ways.
> One is spreading social unrest.
> The second is a bursting housing bubble.
> The third is a global economic slowdown that coincides with a domestic recession. (p. 91)

It is left to Michael Pettis to put flesh on these bare and cheerless bones by detailing exactly how China's development model is rapidly losing momentum and why it must be abandoned. He accepts that the fundamental imbalance it created by prioritising state investment and export-led growth over private, domestic consumption, should be given credit for the high rate of growth that the country enjoyed for decades. But continuing with this approach beyond a certain point (around 2005, it seems) was, he insists, to ignore the lesson taught to most developing countries in the 20th century, notably Brazil in the 1980s; what happens when an increasingly wasteful investment binge got out of control, failing to produce adequate returns and so leading to a rapidly increased reliance on borrowing. The outcome, given that credit is never inexhaustible, is, invariably, a debt crisis and a 'lost decade' or more of economic growth (pp. 32–33). If China's leaders are somehow dreaming that their country is so special that it can defy the pull of economic gravity indefinitely, they are, according to Pettis, in for a rude awakening; 'Once China reaches its debt capacity limits, perhaps in four to five years, growth will inexorably come crashing down' (p. 43).[1]

The key determinant in all of this is value. At the outset of the development process, Pettis argues, loss of value, i.e. waste, is not a serious issue, for '...in the early stages for most countries that have followed the investment-driven growth model, when investment is low, the diversion of household wealth into investment in capacity and infrastructure is likely to be economically productive.' But such benign conditions rarely last. 'The longer heavily subsidized investment continues, however, the more likely that cheap capital and socialized credit risk will be used to fund economically wasteful products' (p. 39), something that is as true of manufacturing as it is of infrastructure, he asserts. This creates the apparently bizarre situation in which 'capital users begin to destroy wealth, but they nonetheless show profits by passing on more than 100 percent of the losses onto households.' The heirs of Mao cannot claim to have discovered a way to escape such a fate, for 'there is substantial evidence to suggest that China's state-owned sector in the aggregate has been a massive value destroyer for most if not all of the past decade' (p. 41). Settling the bill for this destruction, not least in the shape of dealing effectively with non-performing loans, cannot be avoided forever; the longer the reckoning is put off by further borrowing, the greater the eventual damage that will need to be repaired.

According to Pettis, then, in a matter of a few years China's model of state investment will likely come to grief, and in the process public spending and private consumption will begin to move back into balance, automatically. In the most general sense, then, change is completely unavoidable. A rebalancing there will be; the only question is how it will take place and the price that will be paid for it. For if rebalancing cannot be brought about other than through a debt crisis and the socialization of the resulting costs, this presumably means that when investment and consumption do eventually come into line, it will be at very much lower absolute levels for both. How to avoid this? One thing at least is clear to Pettis and other commentators; a return to the *status quo ante,* to state capitalism Mark 1, is not feasible. The financial repression on which it was based, and the export competitiveness that was its crowning glory, both belong firmly to the past, he argues (p. 92). The future, it seems to be widely agreed, lies in transforming the domestic sector and in looking for growth by unleashing China's consumers.

This provides us with our second set of problems; what kind of systemic change should China's policymakers attempt, and how can they manage the transition to a new world most effectively and at lowest cost? The goal is a clear one; to engineer a sharp reversal of a negative trend that has gathered pace since 2000, the year when, Pettis tells us, 'Chinese household consumption represented a meagre 46 percent of GDP...By 2005, household consumption in China had declined to around 40 percent of GDP. With the exception of a few very special and unique cases, this level is unprecedented in modern economic history...[but in] 2011...consumption declined to an astonishing 34-35 percent of GDP. This level is almost surreal' (pp. 24, 27). How much money is to be taken out of the state's pockets and put back into those of individual consumers, and how best, and how quickly, the transfer is to be effected are, though, tricky calculations. Pettis identifies a maximum of six possible scenarios (pp.87-88); none of them, he concedes, is pain-free.

Pettis walks us through again (pp. 101-108) the reasons why one of them, the choice to do nothing, leads in fairly short order to disaster, citing the warnings of that modern Cassandra, Charlene Chu (formerly of the Fitch Ratings Agency), about the ogres that now prowl in the spreading murk of the 'shadow banking' sector. Another option, a radical reduction in state investment, would inevitably produce a surge in unemployment, and although this could initially be offset by creating new public sector jobs, Pettis argues that the net effect would simply be to raise government debt to unsustainable levels, meaning that the cure would be at least as bad as the disease. Other strategies involve taking take direct aim at increasing the disposable income of households, either by raising interest rates on their savings, forcing up the value of the currency, increasing wages, or reducing taxes. Each of these various approaches would affect different sectors of society in different ways (pp. 94-96), but all of them would inflict very significant pain on the state sector, either through higher costs, lost competitiveness, increased cost of capital, or a combination of all three. More than that, such changes would have to be pushed through quickly enough to avert disaster, yet such speedy action would create 'very difficult economic and social conditions,' chief amongst them a massive rise in unemployment (p. 109). Every one of these solutions, then, seems fated to encounter very significant economic obstacles.

For Pettis, but a single option remains; an extensive and genuine program of privatization. This would partly take the form of granting farmers full title to their land and giving residency status to migrants who have left the countryside for urban areas; but at its core would be the transfer of ownership of the commanding heights of the economy into private hands, either those of Chinese nationals or of foreigners. The prize, Pettis believes, would be well worth the having, for the 'combination of privatization and elimination of subsidized capital would end the tendency for the Chinese financial system to waste capital on a massive scale' (p. 112). Yet objections to such a course of action from the political elite would be vociferous. Nor would they necessarily welcome one further benefit of a truly privatized China, the arrival on the scene of value investors to complement the speculators who alone can function in the current environment where any decision to put money into an enterprise is hedged about by 'uncertainty surrounding the quality of economic and financial statement information…[and by] …the large variety of non-economic factors that can influence prices.' Before value investors can be lured to China to help put an end to waste, the seemingly impossible must happen; the government, according to Pettis, 'must downgrade the importance of speculative trading by reducing the impact of non-economic behaviour from government agencies, manipulators and insiders. It must improve corporate transparency' (p. 55). But the insiders are not there by accident, they wield great power, and they will not go quietly. So with privatization the obstacles are not chiefly economic, but political.

So we reach our third question; is dismantling state capitalism feasible under the current political order? Pettis declares more than once that such a question lies outside his area of expertise and that he is happy to defer to 'politically savvy analysts' like Minxin Pei and Victor Shih (pp. 91–92, 113), who argue that privatization would upset so many vested interests at the highest levels that it has precious little chance of being proposed, let alone implemented successfully. No doubt this is the case, although the example of the collapse of the Soviet Union might be advanced to remind the elites that they could well survive and even prosper in a changed world. But even if they were to be so convinced, this would still not get to the heart of the problem of dismantling state capitalism, for the very term itself is a misnomer. What in fact exists today in China is not state capitalism, but Party capitalism, a far more sensitive quantity, one that it is dangerous to name, let alone confront. Privatization in this context ceases to be an economic program; it is viewed by the Party as essentially political in nature and so interpreted as posing an existential threat. Play can be made with the word for the sake of gulling foreign investors, but the brute fact is that a genuinely independent private sector, as understood in the West, is still viewed primarily as a potential rival for power. Entrepreneurs, at least the successful ones, cannot be permitted to lead lives of their own, or to get ideas above their station.

How this is so has been made clear by Richard McGregor. Quoting the words of Dai

Bingguo, a leading figure in Chinese foreign policy under Hu Jintao, that China's 'number one core interest is to maintain its fundamental system and state security,' McGregor comments that 'State sovereignty, territorial integrity and economic development, the priorities of any state, all are subordinate to the need to keep the Party in power' (2010: p. xii). The Party is content to operate behind the façade of the state – indeed it sees it as entirely to its advantage to mask itself in this way. But that does not prevent it maintaining barriers, subtle but unyielding, to any loss of essential control over all aspects of Chinese life, including the economy. And it has a very extensive apparatus to patrol those barriers, in the shape of the Central Organization Department, 'the human resources arm of the Party' (ibid., p. 72), which controls appointments not only within government itself but also in the key state-owned enterprises, powers revealed in dramatic if clumsy fashion in the November 2004 reshuffle of the top executives at China's three big state-owned telecoms companies (ibid., pp. 84–85). The motives of the puppeteers in this and other less publicized instances were transparent; they were faithfully carrying out the work of the Central Organization Department 'as a gatekeeper that ensures the total loyalty of senior cadres to the Party and its leaders' (ibid., p. 76).

It is this obsession with loyalty, just beneath whose surface lies the fear of another Tiananmen, that so greatly complicates any notion of privatizing the SOEs, for it permeates the political membrane in which the entire economy of China is set. Even apparently simple terms like 'property' and 'ownership' find themselves enmeshed in it. As McGregor notes,

> The confusion about what is public and what is private is a deliberate result of the system's lingering wariness about clarifying ownership. Ask any genuine entrepreneur whether their company is private, or *'sinying'*, literally, 'privately run', it is striking how many still resist the description in favour of the more politically correct tag *'minyin'*, which means 'run by the people'. In a people's republic founded on a commitment to abolish private wealth, an enterprise which is 'run by the people', even if it is owned by an individual, is more favoured than a company that parades itself as purely private. (Ibid., p. 200)

In such a world, finding entrepreneurs who see themselves as being entirely independent of the party, and who might therefore be fitted to turn SOEs into genuinely private enterprises, is akin to searching for water in the Sahara. McGregor cites the wisdom of Wang Shi, Board Chairman of China Vanke, which is billed as the largest residential real estate developer in the world.

> In late 2008, Wang summed up the rules he had learnt for doing business as an entrepreneur in China. From the moment he established his private business, he said, he had been careful to take on a government shareholder, to give his company a 'red hat'. 'You take too much, the state is unhappy, and you take too little, you get upset with yourself,' he said. When this first state shareholder was replaced a few years later, he made sure that his new partner was state-owned as well. The first rule, he said, was that you will not develop quickly without a 'red hat', or a state partner. And second, you had better be careful about making it big without one. He had no need to articulate the third rule, which he had learnt in the wake of 1989: to stay out of politics altogether.

(Ibid., p. 208)

No company in any country, of course, can afford to exclude the government from its calculations, but there are not so many regimes whose 'ultimate aim…[is] to have a permanent party presence in every large private company in the country' (ibid., p. 214), nor that see fit to organize sessions for leading young entrepreneurs at the Central Party School in the nation's capital with the dual aims of indoctrination and driving home to them the relatively lowly place in the country's hierarchy that they occupy (ibid., pp. 226–228).

Rebalancing the Chinese economy by transferring resources from the public to the private sector is, therefore, nothing like as straightforward as it sounds. Pettis suggests (p. 112) a variety of ways in which it might be tried, including the distribution of vouchers granting ownership of SOE's to households, but it is difficult to see how this would create the kind of independent corporate governance needed to achieve a decisive break with the model of the past. Without a willingness on the part of the Party to relinquish its grip on the key levers of economic life (thereby putting its own future on the line), the prospects for a managed rebalancing seem remote, meaning that the economic tremors now being felt will almost certainly be allowed to increase steadily in frequency and intensity.

If a managed rebalancing is indeed off the agenda, we arrive at our final question; what will happen if the chief relics of the heroic era of Party capitalism, especially the SOEs, remain in being and increasingly come to act as a drag on economic growth? What will Chinese policymakers try to do, short of taking off their mind-forged manacles? The new leadership installed in November 2012 has begun to give its own answer to that question. Under Xi Jinping, an individual far more forceful than Hu Jintao, an 'ambitious' reform agenda for the economy was outlined at the 3rd Plenum of the 18th Party Congress in November 2013. Change there would be, but it would be measured; while it would mean 'giving the market a "decisive" role in resource allocation' and recognizing 'the equal importance of state and non-state ownership', the issue of state control of assets was firmly excluded from the agenda for discussion, 'privatization was off the table' (Kroeber, 2013). Rather, the new strategy would involve the government removing itself from decisions on the cost of basic economic resources like capital, energy and land on which it had hitherto kept a tight grip. These would now be decided by market forces, which change, it was said, would promote competition within the state sector and so force the SOEs to become more efficient. Private enterprises were also supposed to benefit from easier access to key resources, giving further impetus to competition. Little overt attention was given to the disruptive effects of such a course of action, though observers like Arvind Subramanian have pointed out the difficulties of any attempt to exit from a regimen of 'distorted prices'.

> Adjustments to these prices will no doubt test the Chinese economic system. Realistic prices of capital, and the elimination of financial repression, might reduce growth and result in large declines

> in investment, which has been the engine of growth. In turn, this will cause severe banking system stress. (2011, ch. 7)

But even if such turbulence can be ridden out, how will the new policy promote rebalancing? In what ways will changes in the pricing of resources transfer wealth from the state to the consumer sector? If the price of capital were to be allowed to rise to its 'natural' level, then the resulting higher interest rates would certainly benefit Chinese savers who have endured decades of financial repression (enforced low interest rates) designed to provide manufacturers, predominantly in the state sector, with cheap capital. But would such an increase in spending power not be offset by rising prices that consumers would have to pay for other commodities?

A case in point is one of the most basic resources of all, and one that remains very seriously under-priced just at a time when it is becoming increasingly scarce in China; water. To date there seems to have been no dramatic initiative under Xi Jinping to allow the price of water to rise to reflect its true value and the constraints on its supply, a move that would probably reduce waste and pollution overnight (and these are important enough considerations in their own right, since, as Ma and Adams note (p. 42), 'China's water problems are measured in a variety of ways, and the results are universally alarming'). Government caution, indeed inaction, here is easy enough to understand, though; neither industry, agriculture nor consumers in China would welcome such a rise, to put it mildly. So it has proven much easier politically for China's leaders to engage in competition for water with their country's neighbors (Economy and Levi, 2011, ch. 10) and to push ahead with the grandiose South-North Water Transfer Project that will allegedly solve problems of imbalances of supply, but which has been criticised for ignoring the entire issue of water scarcity and for being likely to result in the creation of as many losers as winners (Hornby, 2014). But even if the political courage could be summoned from somewhere to address the pricing of this particular key resource, using it as a mechanism for rebalancing would need to involve differential price regimens for the state and household sectors, and there is no sign of this being considered. It would also be a spur to state sector efficiency to charge SOEs more than private companies for water, but again this seems to be a bridge way too far politically.

At the root of such immobilism lies fear; fear of unpopularity, fear of another Tiananmen, fear of the annihilation for the Party in the same swift and crushing manner as was visited on its Soviet parent in 1990 - hence the leadership's wariness and barely-concealed trepidation about what has recently been happening on the streets of Hong Kong. In this context, the very noticeable strengthening of the machinery of state control undertaken by Xi Jinping since his ascent to power is no accident, and the new firm hand is just as apparent in the ideological sphere as elsewhere. This, despite the contradictions that it entails, such as those that were implicit in the 'somber, secretive' Document 9 issued to Party cadres in August, 2013, with its attacks not just on 'Western-inspired notions of media independence and civic participation', but also on 'ardently pro-market "neo-liberalism"...[by which] Mr Xi has signaled a shift to a more conservative, traditional leftist stance with his "rectification" campaign...' (Buckley, 2013). The belief that 'market forces' can be harnessed, reined in or spurred on by government according to whim, that the Chinese economy can be controlled and not-controlled at one and the same time, is evidence that the 'identity crisis' which David Shambaugh detects in China's foreign policy (2013, ch. 8) has its roots in a crisis of exactly the same type that afflicts the Party itself; it claims to know what it is and what it wants, but what it is and what it wants are inherently self-contradictory.

In such a world, policy in general, and economic policy in particular, falls victim to the search for simulacra.[2] One of the most recent examples of this concerns the perennial, and perennially vexing, question of rural landownership. Agricultural reform in the post-Mao era under Deng Xiaoping achieved remarkable productivity increases through the 'household responsibility system', under which government quotas were reduced and surpluses could be sold at market prices. But these changes did not touch the land itself, Deng perhaps being mindful of Lenin's 'mistaken' promise of 'land to the peasants,' the fruits of which generosity had to be clawed back at immense cost via collectivisation in the 1930s. Allowing farmers actually to own the land they till is even today too thorny an issue for Xi Jinping to touch, even if he wished to, not least because of the financial dependence of local government authorities on their powers to re-designate such land for industrial purposes and profit handsomely thereby. So instead Xi has just begun to tout a new initiative being promoted in Yangling and elsewhere, one that can only be described as pseudo-privatisation.

> The measure, called liuzhuan, stops short of privatization but gives farmers land-use rights that they can transfer to others in exchange for a rental fee.
>
> The goal is to simulate a private land market and allow China's family-run, labor-intensive farms to change hands and be amalgamated into large-scale, industrialized businesses. (Johnson, 2014)

The 'simulation' here is the hallmark of the Party's involvement in the economy. It appears to grant the fact of ownership without actually doing so, and it depends entirely on trusting what cannot be trusted, since the gift of land-use rights can in both theory and practice be revoked at any point if it proves to be politically inconvenient. It is this problem of trust that is the chief barrier to meaningful reform here and in every other instance.

Evidence for this may be beginning to accumulate in the housing sector, which for the moment is the epicentre of China's economic difficulties. The property bubble may have begun to deflate, but managing the fabric as it subsides is going to be an extraordinarily difficult enterprise, particularly for a regime that has absolutely no experience in the field (though it may take a certain cold comfort from the performance of those did have experience when attempting to manage the bursting of subprime in the U.S.). The way that governmental reactions to the first signs of stress among housing developers have been interpreted is a reminder of how politicized the economy of China remains. Take, for example, the arrest in Hong Kong in late August, 2014, of Chen Zhuo Lin, chairman of Agile Property Holdings, one of the ten largest property developers on the mainland, and his subsequent unexplained detention. It is susceptible of a number of explanations. One is that he had simply forgotten Wang Shi's third law of doing business in China and had allowed himself to become too close to Zhou Yongkang, formerly the immensely powerful head of the country's security apparatus but now one of the chief targets of Xi Jinping's anti-corruption drive. But it has also been noted that his initial arrest 'comes at a time when Chinese property companies are under pressure from government efforts to make housing more affordable in the world's second-largest economy' (McMillan, 2014). In one sense it does not matter whether there is in fact any connection between the arrest and government policy; the simple fact that such a link can be seen as plausible is testimony to the immense power that the Party wields, in this instance through its complete control of the judiciary. All of China's entrepreneurs are just as individually vulnerable as any of the 'crony capitalists' of Vladimir Putin's Russia, and they would be unwise not to own that it does not pay, materially or in any other way, to cross the Party in any respect. They and their wealth ultimately exist on sufferance, so that while a 'red hat' will never afford complete protection to the wearer's neck (as the case of Chen Zhuo Lin may yet turn out to illustrate), it must still be seen as a good deal better than no hat at all.

So under Xi Jinping the fundamentals seem to be unchallengeable, and the purpose of any reform will remain what it has always been since Deng Xiaoping set out to 'liberalize' the country's economy. For even where this seemed to involve opening up the country to market forces and foreign influence in areas like Guangdong and the Yangtze River Delta, the truth of the matters is, as Carl Walter and Fraser Howie remind us,

> There is a parallel economy that is geographic as well as politically strategic. This is commonly referred to as the economy inside the system (*tizhinei*…) and from the Communist Party's viewpoint, it is the real political economy. All of the state's financial, material, and human resources, including the policies that have opened the country to foreign investment, have been and continue to be directed at the system. Improving and strengthening it has been the goal of every reform effort undertaken by the Party since 1978...
>
> The resemblance of today's commercial sector in China, both foreign and local, to that of merchants in traditional, Confucian China is marked: it is there to be used tactically by the Party and is not allowed to play a dominant role. (2012, ch. 1)

Xi Jinping would surely not conceive of himself as standing outside this tradition, and it is hard to see how it can be made compatible with any meaningful strategy of rebalancing, whether through privatization or any other mechanism. Yet all the while, according to Michael Pettis and others, the deficiencies of the developmental model that seemed to serve the Party so well in the past grow ever more noticeable, and its chances of playing a constructive role in

China's future diminish by the hour. As the irresistible force approaches, then, what odds for the immoveable object?

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Notes

1. Economists are understandably reluctant to commit themselves to firm predictions, so we should acknowledge the presence of the 'perhaps' in this sentence. A few pages later Pettis expands on his surmise, remarking that the assumption 'that China will necessarily rebalance in the next few years…is, I think, very plausible. In fact, over the long run it is actually more than just plausible. It is an arithmetical certainty, because it can be violated only if China has unlimited borrowing capacity and the world has unlimited appetite for rising China trade surpluses' (p. 45). That may indeed be the case, but since it is also true that in the long run, as is often remarked, we are all dead, calls for China's leaders to initiate rebalancing are less likely to gain traction the further out the timeframe is extended. They are more likely to be shaken and stirred into action, though, by warnings such as Pettis' 'guess that, at current rates of investment China's debt capacity is unlikely to extend much beyond three or four years. I find it unlikely… that China can maintain high levels of investment growth for longer than that without being forced into a catastrophic adjustment' (p. 105).
2. Nowhere could this be clearer than in Xi Jinping's 2013 conjuring up of the 'Chinese Dream', which 'is about peace, development, cooperation and win-win results, and…is connected to the American dream and beautiful dreams of people in other countries' (quoted by Fenby, p. 8). This trades on meaning, and empties it of content, in one and the same breath.

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