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False Hopes for Chinese Economic "Integration"

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John Lee, Michael Hintze Fellow for Energy Security at the Centre for International Security Studies, University of Sydney, discusses why "China cannot exist as a 'responsible stakeholder' in the international liberal economic order until and unless the regime releases its grip on the levers of economic power."

In a recent online article in *Foreignpolicy.com*, regular columnist and head of the Economic Strategy Institute, Clyde Prestowitz, argued that the next president of the World Bank should be Zhou Xiaochuan, Chairman of the People's Bank of China. For Prestowitz, it was not just Zhou's excellent credentials that made him ideal for the position, but also the fact that he is Chinese. China is accurately accused of "gaming" the global economic liberal order through its currency policies, restricted market access for outside firms and governments, and internal intervention in the economy to the detriment of foreign firms. But Prestowitz believes that such an appointment would significantly encourage China to behave as a "responsible stakeholder." Behind this thinking is the argument that the more power, prestige, and authority China accumulates within the existing order, the more liberal Chinese economic policies will become.

The hope, or else belief, that authoritarian China will be increasingly "integrated" into the liberal order that it presently thrives in is seductive. But such a line ignores the worldview of the Chinese Communist Party (CCP), the structure of the country's political-economy, and the incompatibility of the CCP's strategy to remain in power vis-à-vis such genuine liberal integration. China will continue to participate in the liberal economic order because it has no alternative and needs to do so. But the argument that it will willingly change in order to become increasingly integrated into the rules and norms of the existing order is less persuasive.

Every student of international relations knows that the global liberal order is characterized by rules-based competition, dispute resolution processes, and open economic and trading systems. Less well understood are the implications of such an order. No liberal system can function effectively without the significant separation of political, economic, legal and administrative agency and agents. Governments genuinely committed to a liberal system of rules and competition use the tools of state to uphold the agreed rules of the game. But they voluntarily give up much of their capacity to intervene in legitimate competition between firms, engineer economic outcomes, and determine the winners and losers in the hurly-burly of economic competition. Conflating business with political goals should be the exception rather than the norm. The problem is that the CCP ultimately seeks opposite ends.

China is frequently, but inaccurately, described as a private-sector driven economy under an authoritarian system. It is in fact a state-driven and state-dominated economy. There are around 150,000 centrally and locally managed state-owned-enterprises (SOEs) in China, compared to about five million private corporations and millions more informal businesses. Although vastly outnumbered, the most important and lucrative sectors of the economy are reserved for SOEs to compete in amongst themselves, while domestic private and foreign firms remain locked out. Additionally, SOEs receive around 75 percent of all the formal finance and own approximately 70 percent of all fixed assets in the country, and dominate investment activity in every sector except for manufacturing—which is dominated by

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private export manufacturing firms.

Such dominance is evident in the fact that all but approximately one hundred of the 2,037 firms listed on China's two stock exchanges are majority owned and controlled by SOEs. The ten largest Chinese firms by revenue and/or profit are all state-controlled. In 2009, two SOEs—China National Petroleum and China Mobile—made more profit than the top 500 private firms in China combined.

The link between the CCP and SOEs is also extensive. Although China's SOEs are called upon to nominally behave as profit-making entities, they are ultimately viewed as tools of the regime. This is clear from the structure of ownership and authority. Controlling shares in SOEs are held by the State-owned Assets Supervision and Administration Commission, which is directly answerable to the State Council, the country's top legislative body—similar to the US Congress. When it comes to personnel, the senior managers of all large SOEs are almost always CCP members. The three most senior positions—Party Secretary, Chairman, and CEO—of the fifty largest SOEs are appointed by the Central Organization Department, headed by a member of the Politburo. In almost every case, appointees are CCP members.

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In offering SOEs privileged market opportunity, protection, cheap loans, tax and subsidy advantages, senior management in SOEs are explicitly expected to follow political directives in addition to engage in normal economic activity. The return of the state in the Chinese economy is designed to ensure that the CCP remains the primary dispenser of economic and commercial opportunity in the country—and in doing so prevent the emergence of a genuinely independent and influential middle class. In turn, SOEs have become powerful entities within the Chinese political-economy. The upshot is that China's powerful SOEs expect CCP support in seeking ever expanding domestic and foreign market opportunities.

As far as the CCP is concerned, participation in the international liberal order is necessary for China's continued development, but is also the "Trojan Horse" that the axis of liberal democracies uses to weaken the CCP, hasten the emergence of an independent middle class and pluralism, and, in doing so, promote democracy in China. Preserving and reinforcing the state-dominated political-economy remains the CCP's most effective shield against what it considers to be outright subversion by foreign entities and governments. As far as China's role in the global economy is concerned, several implications flow from this setup.

First, China will continue to deny meaningful access to foreign firms in key economic sectors in order to protect its own SOEs. This explains China's emphasize on building "national champions" as part of its indigenous drive. Foreign firms will only be granted access in order to hasten technology and know-how transfer into the Chinese market.

Second, Chinese foreign policy will be largely determined by the needs of its SOEs. Beijing's "going global" strategy has been designed to secure guaranteed access to resources, obtain advanced technologies, and create or expand markets for SOEs. Indeed, four-fifths of all outbound Chinese investment is undertaken by SOEs.

Finally, the CCP will remain willing to massively misallocate capital for political purposes. The country's SOEs compare poorly to both domestic private and foreign firms. But they will continue to receive the lion-share of capital and opportunity since SOE expansion is a key pillar of the CCP's strategy to remain in power.

China cannot exist as a "responsible stakeholder" in the international liberal economic order until and unless the regime releases its grip on the levers of economic power. Unfortunately, and despite every economic logic for it to do so, holding on to economic power is intrinsic to the Chinese Communist Party successfully holding onto political power.

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