

# Will Xi Jinping Succeed?<sup>1</sup>

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We need a different way of understanding China and a very different way of viewing its current leadership. China is the latecomer of a group of Asian miracle economies. It faces a turning point shared by all the Asian miracles, a crisis of success.

These crises of success are caused by complexity. Economic success creates a highly differentiated society. The extraordinary complexity of a modern economy can't be managed in detail from the offices of the top leaders. Likewise, the social complexity requires different political management. The moment when complexity makes change imperative is a crisis of success, a moment in development of a successful business or a country where continued success requires organizational transformation.

Think of an entrepreneur who invents a cool widget and the business takes off, managed as the entourage of that one successful inventor. Soon the point comes where a simple business becomes complicated. It needs to list on the stock exchange. It needs professional accounting and professional human resources management. It needs a board of directors and a public rule book. Future success or

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failure depends on successful transformation. Call it an Elon Musk moment. Xi Jinping's job is to manage China's Elon Musk moment.

These crises of success share certain characteristics. Like South Korea and Taiwan in the 1980s, China finds itself overleveraged, threatened by debt, bubbles, inflation and bankruptcies. The big companies find themselves indebted and unprofitable. Politics also grows more complex, with rising demonstrations and powerful interest groups demanding control over policies.

How has China's crisis of success emerged? Start with Zhu Rongji. In his desperate effort to use market reforms to save the banks and the big enterprises from collapse, he moved 45 million manufacturing workers to new, mostly service jobs between 1994 and 2003. Remember what happened to U.S. politics when only 3 million manufacturing jobs disappeared in a decade. And Zhu sought to cut the Chinese government in half. Imagine Ronald Reagan trying to cut the U.S. government in half. It could never happen. In China, it mostly did, at the top levels.

Initially people accepted the social stress as the price of saving the country. But by 2001-2002 Chinese society was stressed out. People just weren't going to take it anymore. Zhu became a hated figure. Today he's a retrospective hero, and that's the appropriate assessment, but not when his term ended.

So Zhu Rongji was succeeded by Hu Jintao, who promised a harmonious society, a phrase with deep philosophical underpinning, but in practical terms it meant: no more stressful Zhu Rongji market reforms. Hu was a weak leader, crippled by

diabetes. His team of nine Politburo Standing Committee members worked by majority vote, slow like the U.S. Supreme Court, and older leaders frequently interfered. Economic and political reform largely stopped. Often ministers didn't obey the prime minister. Local governments didn't obey the center. A hugely corrupt military focused on wealth, not combat readiness. Demonstrations increased from 20,000 per year to 180,000 before China stopped publishing statistics. Powerful interest groups were asserting authority over policy.

An example of a powerful interest group is the Petroleum Faction, which controlled the flow of hundreds of billions of dollars worth of energy. It arbitrated the difference between the official price and the market price and pocketed much of the difference. The head of the Petroleum Faction, one of the nine Politburo Standing Committee members, was China's chief of security. China's interest groups are the size of European countries and as difficult to manage as the EU.

*This is China's crisis of success.* The leaders had to re-start economic reform and restore central authority.

On economics, they worked with the World Bank, American Nobel Prize winners and many others to develop a plan based on market allocation of resources. Seldom in world history has an economic plan been so thoughtfully prepared. The basics were published in *China 2030*, a joint effort with the World Bank, before Xi was chosen as top leader.

Politically they saw the challenges as requiring drastic centralization. They cut the Politburo Standing Committee from nine members to seven and, to make consensus easier, eliminated the most extreme views (Bo Xilai, Wang Yang). They created a new National Security Council and also created new small leading groups to manage things like military reform and economic reform and Taiwan policy and put one new leader in charge of all of them. They gave the new leader immediate control of the military and told the older leaders to stop interfering. These were consensus decisions, separate from the decision to choose Xi Jinping as the new leader.

Immediately the problems began. Market allocation of resources implied squeezes on the state enterprises and therefore on the banks, upsetting both. If the market was making decisions, then discomfited Party and government groups were losing power. Simultaneous military reforms added the military to groups pushing back. Above all, reforms put local governments in a terrible squeeze. In short, the reform plans threatened all major power groups in China. There is no more dangerous strategy for a leader than one that threatens all major power groups simultaneously.

But Xi Jinping had a hammer to employ against resistance: the anti-corruption campaign. Not surprisingly, the first tiger brought down was Zhou Yongkang, head of the Petroleum Faction, followed quickly by top military leaders. But the broad application of the anti-corruption campaign meant that the interests of all major

power groups in Chinese society were doubly threatened. That meant double trouble.

Xi Jinping's team came to power worried about a suspected coup plot. Their threat to so many groups' power led to spectacular infighting. One top executive told me, "Bill, the game in Beijing is, you die or I die." This is not the image we get in our media, of the perfectly coiffed, confident leader with all his dutiful, identically dressed colleagues lined up behind.

Adding injury to injury, the anti-corruption campaign, intended to be the hammer of reform, scared and immobilized the officials responsible for reform. Any reform stepped on someone's toes. The owner of the injured toes would say, "You're corrupt!" Most reformers were vulnerable to this accusation and therefore were immobilized.

Because of this political warfare, Xi Jinping's first term had to be devoted to subduing rivals. This he accomplished superbly. The second term, begun a year ago, is designated for implementation of reforms. Some leaders then realized the risk of reversals, like Trump reversing Obama's key achievements, and of reprisals, and therefore rushed through the ill-considered possibility of a third term for Xi.

How is reform doing? In almost every important case except military reform, when the leadership has faced a fundamental choice Xi has announced that the regime will have its cake and eat it too.

- They had a choice: fast reform with slow growth or fast growth with slow reform. They announced that they would have both. The reality has been slow reform.
- They will move to market allocation of resources, but they will provide \$1.7 trillion in subsidies to state enterprises.
- They will marketize the state enterprises, but in every state and private enterprise they will strengthen the Party Committee's control of strategic business decisions.
- They will create a level playing field, but they will consolidate national champions and exempt state enterprises from the competition law.
- They will emphasize the rule of law, but they will strengthen the Party Commission that tells the courts what to decide.
- They will obtain public input on corruption and environment problems, but they will crack down on even limited public complaints.

This determination to have one's cake and eat it too is not leadership like Mao Zedong or Deng Xiaoping. This indecision is more like Theresa May explaining that Britain will have both Brexit and a gloriously prosperous future.

But the indecision is not completely indecisive. Whenever there is a tension between market reform and political control, this leadership leans mainly toward government control. Mao Zedong's era was Politics in Command. Deng Xiaoping's era and Jiang Zemin's were Economics in Command. Hu Jintao's was Patronage in Command, expanding the already vast Party-government bureaucracy to 80 million

people and expanding corruption. Xi's era is Politics mostly in Command. That is ominous for the economy.

Recognition of this strategic indecision illuminates the role of Xi Jinping. Our media, and many specialists, describe Xi as the omnipotent President for Life, as China's Putin. That image is totally misleading.

Xi is powerful. He has eliminated his adversaries. He has many titles and roles. He is enshrined in the constitution. He has eliminated his term limit. He is promoting movies and speeches that attribute China's new greatness mainly to himself and his father, not so much to Deng Xiaoping.

But the important test of a leader is whether he can achieve the agreed policy goals. Xi is hardly all-powerful on that dimension. He faces universal pushback, together with personal political priorities that overshadow economic reform, and therefore limited success.

Xi is not China's Putin. Xi is a creature of the Communist Party, an executive given a job to do and ultimately accountable for performance. Putin's party is a creature of Putin, engineered just to enhance Putin's wealth and power. This contrast is entirely in China's favor but it belies the image of Xi as the all-powerful dictator for life.

The sober reality is that Xi has a job to do and he is not doing that job. He is not reforming the economy. The consequences take a long time to ramify. Jeff Immelt

held on a long time overseeing GE's incapacitation, and China is a lot more complicated than GE.

Confident, competent executives do not accumulate all possible titles and roles. Imagine a big company where the CEO has made himself director of every operating division. That would reflect fear to delegate, not confidence. This overcentralization leads to decisions that are usually too slow and in urgent situations like the 2015 stock market drop too hasty. In contrast, Deng Xiaoping governed China with one title: honorary chairman of the Chinese Bridge Players Society. Deng would give a speech at the age of 80 and soon a billion people would live differently. That is incomparable authority.

Now I want to offer two complementary perspectives. On one hand, China faces severe political problems. On the other hand, it is not at risk of a great revolution.

A key lesson of the earlier Asian miracles is that the pressures of political complexity are inexorable. The current Chinese administration has chosen a strategy of sitting on the lid of the boiling political kettle. The result is a vicious circle of repression, pushback, more repression, more pushback.

The tides are shifting. Groups that strongly supported the government are becoming alienated. Five years ago China was one of the few developing countries where academics supported the government—on the reasonable view that, while there was repression they didn't like, the Party had done so much for the Chinese people that the costs of repression were quite tolerable. No more. China's

professionals, academics, journalists, lawyers, the leading edge of society, today express helpless but emphatic alienation.

Of decisive importance is the business community. State enterprise executives have lost more than half their previous compensation. They're not happy. But the private sector, the source of almost all growth and almost all new jobs, is most decisive.

Virtually all growth and all job creation comes from the private sector, but the private sector is being squeezed financially and devoured by the state enterprises.

Private sector investment growth has fallen by two thirds. Every private company is vulnerable to the local Party Secretary, who calls up and says, "I have a new project downtown. I need your million dollar contribution by next Tuesday." That causes resentment.

Today the local Party Secretary finds herself squeezed by the national campaign of financial deleveraging. China's localities have a disproportionately large share of social responsibilities and a disproportionately small share of revenues. With deleveraging, now there will be three new projects requiring donations. The economic and political costs are going to be severe.

Add together the discontents of all modern professions, local governments, powerful central Party and government groups, state business, local business, and the most salient religious groups, and you have a tidal shift, gradual but ultimately decisive.

Western media and politicians look at Xi's many titles and see a stable dictator for life. The Chinese people look at the same facts and see fear and potential

instability. It's almost impossible to find an upper class or middle class Chinese family that does not wish to get its money and its children out of China. The pressure for capital flight has forced strong capital controls and a reversal of the government's efforts to make the Chinese currency an important global currency.

On the other hand, this shift against the administration does not mean that China is headed for a great revolution. The fundamentals of the governance system created by China's Communist Party are as strong as the ones created by its Leninist predecessors in South Korea and Taiwan. But, to understand this, one has to discard much of Western social science. Nothing highlights the malign influence of ideology and methodological fetishism on contemporary economics and especially political science so much as a look at the realities of China.

Start with environmental issues. It was long a shibboleth of Western academic studies of China that, because of the iniquitous Chinese communist system, China has the world's worst pollution. On the contrary, when those studies were being published the effect of air pollution on human health was already eleven times worse in democratic India than China. Chinese cities do not make the top 100 of the world's most polluted cities. Like London in 1950 and the U.S. and Japan in 1970, China just had to get through a development threshold where basic needs were assured and environmental shocks mobilized action. China has become the biggest investor in environmental improvement, more than the U.S. and more than all of Europe. It is a leading advocate of action to inhibit climate change. It is the leader in every form of green energy.

Then look at economics. The greatest development economists of our day, Acemoglu and Robinson, have shown persuasively that sustained development requires a relatively inclusive *economy*. They frequently derogate China on the grounds that it is not an inclusive *polity*. The assumption is that an inclusive economy is the same as an inclusive polity. But that is ideology, not science. At China's level of development it happens to be the opposite of the truth.

The Leninist Asian miracle economies specialize in creating inclusive economies, and they greatly outperform democracies at this level of development. They begin by taking the greatest asset of their agricultural societies, land, and distributing it widely in a great land reform. Democracies are, with the sole exception of Costa Rica, incapable of land reform. Then the Asian miracle economies provide universal basic education so that everyone has a chance. India among others has proved unable to do this for its people. Then they build infrastructure to attract labor-intensive industry and gradually get nearly everyone a job in the modern economy. For comparison, China builds about as many modern roads every six months as India has built since independence in 1947.

The economy based on labor-intensive textiles, computer assembly, and the like particularly benefits women. In most traditional agricultural societies families have an overwhelming preference for boys, because family survival may depend on muscle power. In modern light industry companies strongly prefer women. A typical textile or computer assembly plant may have 11 Taiwanese bosses and 8,000 Chinese women. It's still unfair that the bosses are Taiwanese men, but for most

Chinese families the key is that the women are the ones who get primary exposure to the modern world. The women are the ones who can save and fund the downpayment on a home. The women get out of the villages where previously they were under the very oppressive thumbs of their fathers and brothers. Women travel 500, 1000, 1500 miles to get these jobs and they cite getting out of the village as the greatest benefit. A key indicator of the shift: In the old days women had to provide a dowry. No more. Now men have to show that they can provide an apartment or women will not date them. That is a male dowry.

Next these Asian miracle economies promote widespread homeownership. China has the world's second highest rate of home ownership—around 85 percent. The U.S., which encourages homeownership, is about 20 percentage points lower. The number of Chinese families that own a home is about twice the number of Indian families that have access to a toilet. Which system is inclusive?

Finally, each of these economies experiences a great property price inflation, making people's homes far more valuable.

That is how to create an inclusive society in a poor country.

Similarly, contrary to much of the Western academic literature, China has developed an effective meritocracy. Much of the Western academic literature has that completely wrong; if you believe that Chinese administration is all patronage and no merit, you can't explain why China builds more and better roads than India. Likewise, most of the literature on Chinese corruption fails to understand that

Chinese corruption, which does not undermine national policy, is much less deleterious than Indian corruption. I have addressed these issues in detail in a recent book, *China's Crisis of Success*.

In sum, like its predecessors in South Korea, Taiwan and Singapore, the leaders have built very solid fundamental systems that will survive changes in top administration.

What does all this mean for the economy? Growth, while still relatively high, has been declining for years and will continue to decline. Growth is less than the official statistics show. Growth is being sustained by unproductive investment, paid for by rapidly increasing debt. Political officials are being given final authority over business strategy in all corporations. China will not have a great financial crisis. But rising debt, the squeezed private sector, and the rising emphasis on subsidies and protections and consolidations for big state enterprises threaten China with a slide into Japanese-style stagnation. Three decades when government revenues grew twice as fast as a fast-growing economy have created a bull market mentality where success seems inevitable and all things seem affordable, but that era is ending. Socialist politicians think that direct control of huge companies will enhance the political leadership's power, but the lesson of history is that the big companies end up owning the politicians. That leads to protectionism and stagnation.

Like Japan in the mid-1970s, China is turning inward. In 1965 Japan's mentality was: seek out best practice everywhere and bring it back to Japan. By 1975, it was:

superior growth is due to unique Japanese cultural traditions. Along with the big companies' control of politics, that spurning of globalization caused Japanese stagnation. While China's economy is far more open and competitive than Japan's, its inward turn is becoming relatively as decisive as Japan's. Six years ago, a stay at Harvard almost guaranteed a Chinese official or professor rapid promotion. Today it raises questions of loyalty. While foreign investors in China still make more money than in Japan, regulatory uncertainty for foreigners and special advantages for local firms make management increasingly difficult. Xi Jinping speaks eloquently of reform and opening, but the dominant reality is backsliding and closing. During the Cultural Revolution there was a phrase for this: waving the red flag to defeat the red flag. This risks gradual stagnation.

That is what Xi Jinping was hired to prevent, but that is the likely outcome of his policies so far.

Finally, China faces a very fundamental political problem, one that is not much remarked in Western commentary, namely the evolution of the Chinese Communist Party from a vanguard party into an interest group.

China's early reformers took extraordinary risks to save their country. In a population of peasants, communist political power was ensured by absolute control over the life of every peasant, through a system of communes that gave the Party control of job, income, location, marriage, clothing, haircuts. But when farmers in Anhui Province started seizing their land back, threatening communist levers of power, Deng Xiaoping noticed that the economy grew much faster and the farmers

were much happier. He decided to take an extraordinary risk: surrendering the most important lever of communist power in the hope that more prosperous people would support the Party. Looking back through an economist's lens that decision seems straightforward. At the time, through a political lens, it was a terrifying risk. But it worked.

Later, Zhu Rongji and Jiang Zemin did the same things with urban industry. Their bet also worked.

That kind of behavior, taking great political risks in the belief that improving society will ultimately enhance support for the regime, is the essence of a successful vanguard party. It is the political core of the Chinese miracle.

The counterparts today would be Party decisions to step back from direct control of big enterprises and from direct control of the courts, accepting a diminution of political control in return for the gratitude induced by improved livelihoods and a more secure sense of justice. But today the policy is to grasp every lever of power, however small. That policy transforms the Communist Party from a vanguard to an interest group. Consciousness that the Party's claim to be a revolutionary vanguard has become hollow will emerge quite gradually but ultimately will undermine Party authority.

What does all this mean for the future?

China does not risk sudden financial or political collapse. Its problem is a gradual accumulation of economic and political sand in the gears.

Resistance to policies that undermine China's productivity growth and political legitimacy is gathering force. Almost nobody acts, because everyone is afraid. But famous professors do speak out. Students, knowing they will be incarcerated, create "Marxist societies" to help organize workers. Local officials ignore Xi's repeated environmental edicts. Party leaders murmur their dissent. Millions of families quietly seek to get their money and their children out.

There is an emergent working consensus among China's elites that Xi Jinping is taking China in the wrong direction. While his environmentalism remains popular, the anti-corruption campaign is now seen as cynical. Large numbers of government and Party officials want to get out. The sense of being able to do great things for their country has evaporated and high officials fear being held responsible for whatever consequences emerge. An increasingly common slogan is, "I promote you because I hate you," expressing the fear of being held responsible for what comes next. To inhibit officials from resigning the government has imposed a three-year period of garden leave that renders officials unable to earn a living outside the government in their area of expertise.

China today reminds me of the supersaturated liquids we studied in high school chemistry. Hold up the glass and it looks like clear water. But tap the glass and suddenly a lot of stuff precipitates out. What will precipitate is impossible to predict. What is predictable is that it will either get much better or much worse. It cannot remain the same.

Xi Jinping has failed. But the denouement will be quite prolonged. Everyone is afraid. China's tragedy is that no one is in a position to succeed.

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