

Things you may think you know about China that aren't quite so

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The title of this talk is inspired by an aphorism by Mark Twain, the great American author and wit. It may already be familiar to those of you who have seen the film *The Big Short*, about the global financial crisis of 2008. Twain observed that: "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." Twain's insight is particularly apposite to today's China and to how it is perceived, both by its own people and by the rest of the world. For much of what many people think they know about China is - if not plain wrong - based on misconceptions, partial truths or myth.

This matters, because what happens in China is increasingly important to the world. It is, if not yet a global leader, increasingly the indispensable nation, whose acquiescence or involvement are essential in an ever larger number of fields in which international co-operation is key. If China is to play a full role and contribute fully to such efforts, other countries need to be clear about what and whom they are dealing with and learn to distinguish illusion from fact.

It also matters because misreading signals and misunderstanding others' agendas and intentions can have very serious consequences. As history has repeatedly shown, that is how differences between nations can escalate into confrontations, and confrontations into outright conflict. That risk is particularly great at a time like the present, when the world is exhibiting worrying signs of instability and disorder.

So I would like to make clear at the outset that my intentions in this talk are constructive. Though I will have some critical things to say about China's government and its policies, I am not a China-basher. My aim, rather, is to

try to cut through some of the fallacies that I often hear repeated about China and to present what I hope is a slightly more accurate picture.

Collective myth-making is, of course, not unique to China. It is actually a central element in defining national identity in many, probably most, countries. Ernest Renan, the 19th century French historian and political philosopher, argued that "Forgetfulness, and I would even say historical error, are essential in the creation of a nation." More than half a century or so later, Karl Deutsch, the Czech-American political scientist, put the point even more bluntly, when he described a nation as "a group of people united by a mistaken view about the past and a hatred of their neighbours."

Thus, the Japanese are united by, among other things, a belief in their ethnic homogeneity that defies the variety of facial shapes and skin colours visible on even a short stroll along a crowded Tokyo street. Many Americans, especially conservatives, cling to outdated or strangely distorted concepts of theirs as a frontier society or of what their founding fathers stood for; and the British to a peculiar sense of innate national superiority based on geographic separation from the rest of Europe, a lingering imperial nostalgia and a victory in the Second World War that would have been unachievable without massive US and Soviet involvement.

But nowhere, in my experience, is myth-making more prolific and more pervasive than about China. There are two main reasons.

One is that China's Communist Party, out of political self-interest and in an effort to forge national cohesion, has deliberately fostered or created many of the myths. It has done so by ensuring that only its approved version of history is taught in schools, by periodically whipping up popular nationalistic feeling against other countries – especially Japan - by playing on a sense of national victimhood, by suppressing dissent and by operating a large, lavishly resourced and constantly expanding propaganda machine that promotes the official line, both at home and abroad.

The second reason is that the speed and scale of China's rise have so bewitched and dazzled observers abroad that many have sometimes seemed ready to believe that its rulers are near-infallible supermen and the reach of its ambitions and potential achievements almost limitless.

Thus we have seen a torrent of articles and books in recent years lauding the supposed advantages of the “China model” and its authoritarian system in getting things done. One book was even entitled “When China rules the world”. To be fair, I am told the author no longer believes that is going to happen; and, of course, some other authors and commentators have regularly predicted China’s impending collapse, which also has yet to occur.

The sharp slowdown of China’s economy and the bungled handling of last summer’s stock market rout and currency regime adjustment have taken some gloss off the country’s halo and raised awkward questions about the once legendary competence of the country’s rulers. Yet in many places, in business and in foreign capitals, the tendency to accept unquestioningly the image of China that its rulers like to project to the world, or to view the country through a distorting mirror, remains strong. Indeed, such beliefs have tended to become conventional wisdom, stated and re-stated as fact.

Let me start with the notion that the Chinese are great long-term thinkers. One hears this assertion again and again. Yet there is little solid evidence to support it. So little, indeed, that I sometimes wonder if it did not originate in a famous misunderstanding that arose when a foreign visitor asked Zhou Enlai in 1972 about the significance of the French revolution and China’s premier replied that it was “too early to say”. That he was actually talking of France’s student revolts just four years before, not of the uprising that overthrew its monarchy in 1789, became clear only later. But by then, the incident had become legend.

In my experience, the only real trace of long-term Chinese thinking is to be found in the unshakeable determination of the leaders of its Communist Party to perpetuate forever its monopoly on power and its right to absolute control. Yet, in pursuit of that goal, they are prepared to switch tactics and even reverse direction suddenly and unpredictably in response to changing circumstances. Deng Xiaoping’s uttered his famous dictum about “crossing the river by feeling the stones” not because he had a clear vision of the way ahead and a reliable roadmap to guide him - but because he didn’t. He understood, rather, that the future was unknowable and perilous and that the only sensible way to advance was one step at a time. Adaptability and readiness to experiment, not rigid commitment to some fixed long-range strategy, have been key to the Party’s survival in power.

If it were really true that China's rulers thought long-term, how have they failed to foresee and avert repeated mishaps and setbacks, many of them self-inflicted? How to explain the economic disaster of the Great Leap Forward? Why did President Hu Jintao, whose time in office is now widely described as the lost decade, shrink from instituting the structural reforms that Chinese economists have long insisted are essential, and instead preside over an unsustainable property bubble? Why did he allow the spread of rampant corruption that his successor regards as so threatening to the Party's future that he has made rooting it out his number one priority? Why did Beijing unleash in 2008 a tidal wave of credit stimulus so large that the country's total debt to GDP ratio now exceeds that of the US and imperils the stability of its economy and financial system? And why did the Party allow environmental degradation to reach such alarming proportions that it severely jeopardises health and has reduced water resources to danger level?

A second, closely related, belief is that China's authoritarian government and central planning are inherently more efficient and effective than democratic systems and are largely responsible for China's breathtaking economic development. There is some truth in this. The Communist Party does exercise extensive state control over the economy that has enabled it to mobilise vast financial resources and channel them into investment, notably large-scale infrastructure projects. And bulldozing people's houses to make way for a motorway or an industrial estate is, let's face it, easier in an autocracy than in a democracy.

However, those economic achievements are not unique to China. Many foreign observers were similarly enthralled by the Soviet Union's rapid industrialisation under Stalinist central planning in the 1930s and its economic performance in the 1960s, until the miracle began to fall apart. Authoritarian regimes elsewhere in east Asia, notably in South Korea, Singapore and Malaysia, pursued similar policies during their earlier, fast-growth phases. Furthermore, comparably bold infrastructure programmes have also been conceived and successfully implemented in countries with a longer history of democracy. One thinks of the vast interstate highway construction programme in the US, a foundation stone of the economy's post-war development, of France's TGV, motorway networks and nuclear power system, of Japan's bullet train and even of Switzerland's famously efficient railways.

It is also worth recalling India's experience. A few years ago, Indian businessmen, frustrated by their country's failure to reform, would cast envious glances at China and complain that what was holding India back was democracy. What they forgot, though, was that things didn't work any better in India when Indira Gandhi temporarily imposed dictatorial rule by seizing emergency powers in the 1970s. Indeed, the episode is now widely judged to have been a near-catastrophe. Everything we know suggests that, when it comes to economic development, the quality of governments and their policies matters more than their particular constitutional form or style of rule.

It is now also increasingly clear that China's development model has come at a high cost. It has been funded by heavy reliance on financial repression, which has lowered household income and therefore consumption and living standards, by depressing returns on savings. Today, Beijing is striving hard to reverse that trend and rebalance the economy by raising incomes and consumption. The China model has contributed to a massive surplus of loss-making and highly polluting industrial capacity, as state-owned banks have fallen over each other to lend ever more money to questionable investment projects yielding steadily diminishing or negative returns. At the same time, local governments have competed to outdo each other and win favour with Beijing by reporting ever larger – and ultimately unsustainable – annual growth rates. All this speaks not of a far-sighted system of meticulous state planning, but of weak overall control and short-termism, abetted by an economic system riddled with distortions and perverse incentives.

In reality, the true heroes of China's growth miracle are not all-knowing master planners in Beijing, nor the country's bloated state-owned enterprises, which continue to dominate many important sectors of the economy. They are China's dynamic, resourceful and agile private companies. Overall, they are vastly more efficient and have created far more jobs than their state-owned rivals, even though official discrimination has long restricted their access to finance and locked them out of many important national markets. A plausible case can be made that much of China's rise happened despite, rather than because of, state intervention or because the state stepped back enough to allow enterprise room to flower.

Let me now examine a third claim, or rather two claims, often made about China, by Chinese and by foreigners alike. These are that China has a very long history and a continuity of culture and civilisation that sets it apart from

and above those of other countries. China has a long history, no doubt, but not markedly longer than those of a number of other countries.

Indeed, China officially laid claim to a history of only 3,000 to 4,000 years until 1999, when its then president, Jiang Zemin, visited Egypt and discovered that its history dated back 5,000 years. On his return to Beijing, he ordered that proof be found that China's history was equally long. A frantic, though only partially successful, scramble then took place to assemble the necessary evidence, which relied in part on incorporating into Chinese history figures such as the Yellow Emperor, whose existence is no more certain or better documented than that of England's King Arthur and is similarly shrouded in myth and legend.

And what of China's civilisation and culture? They are undoubtedly rich and highly distinctive, but they can hardly be said to have developed along an unbroken line, as is sometimes imagined. For a start, as old maps clearly show, China as a geographical entity has repeatedly changed over the centuries as its borders have been continuously redrawn. And its rulers, during long and formative periods of its history, have not been the ethnic Han who now dominate its population, but foreign invaders, notably the Mongols and the Manchus. Nor is China linguistically homogeneous. Almost a third of its population do not speak mandarin as a first language, despite strenuous official efforts to promote or impose it. According to the government, many of those who speak it do so rather badly.

Given China's heavyweight global status, it is also striking how limited have been the spread and impact of its culture and civilisation beyond its own borders, at least, in recent times. Its most emblematic and internationally recognised figure by far is still Confucius, who lived some 2,500 years ago. But though his precepts were highly influential in Japan, Korea and Vietnam, they have not extended much further. And while China is justly renowned for the extraordinary number of scientific and practical inventions that it gave the world, these had largely petered out by the 17th century, for reasons about which scholars still argue.

Nor has any big new idea emerged from China since then that has had a powerful and lasting impact on the rest of the world. Indeed, in recent times, much of the flow has been in the opposite direction. Though Maoism attracted many young enthusiasts abroad in its heyday, its founding Marxist-Leninist ideology, to which China's Communist Party still subscribes, was

imported from Europe. In any case Maoism's true believers around the world – and indeed in China - have greatly dwindled in number.

When China inspires awe and admiration nowadays, it is mainly because of its material achievements and its sheer pace of change, not because of its cultural values, social model or intellectual originality. Of its internationally best known artists and writers, a number, such as Ai Weiwei and Yu Jie, are targets of state harassment and persecution at home. China is also unique in having thrown its only liberal arts Nobel laureate, writer Liu Xiabao, into prison on what many foreign observers consider trumped-up charges.

All this is a decided handicap for a government that yearns to exercise soft power. But for all its strenuous efforts to win friends and influence people beyond its own borders, China's diplomacy remains predominantly transactional and money-centred: the currency of its international relations consists largely of, well, currency, or more specifically, of offers of renminbi in one form or another. And while China's foreign policy experts expend much time and resources on analysing international affairs, the results are often plagued by incoherence and contradictions and, sometimes, betray surprising blindness to all-important foreign nuances and sensitivities. Why that is so is a complicated question which we can go into later if you wish.

But how much actual power does China's money buy? The short answer is: less than commonly believed. The recent jitteriness on international markets caused by the slowdown in China's economy undoubtedly demonstrates that its fortunes have an impact far beyond its national borders. But impact is not the same thing as influence, especially when a major reason why markets have been jumpy is because of concerns that China's economic managers may have lost the plot.

Still, China has more than US \$3 trillion in foreign exchange reserves and that war chest – though it has recently shrunk - must surely give it international clout? Well, to a limited extent, yes. Of course, money is helpful when seeking to influence others, particularly smaller nations, whose support is needed in international forums such as the UN. However, there are limits to how far China can use its foreign exchange reserves as an instrument of political power without damaging its own interests – and for that reason, it rarely does.

If, for example, Beijing tried to pressure Washington by threatening to dump all its US Treasury bonds, a mere whiff of such a plan would cause market panic, and a slump in the value of China's holdings. Nor, incidentally, would that affect over the longer term the US ability to finance its budget, though it might worsen its current account deficit.

Of course, a growing proportion of China's overseas assets is now invested in tangible assets: mines, oilfields, factories, real estate and businesses. But these have been acquired overwhelmingly for commercial reasons: in order to supply China's appetite for national resources, obtain technologies, brands and knowhow and enable its companies to go global. To try to use them for overtly political purposes would not only frustrate those objectives; it would invite retaliation and possibly expropriation by host governments. Beijing is acutely sensitive to that risk, which is why it is so eager to negotiate investment treaties with the US and EU to protect its assets there.

In truth, China is probably more captive than master of the global financial system – much to its own frustration. Seven years ago, Zhou Xiaochuan, the impressively capable governor of its central bank, gave voice to that irritation by calling for creation of a new global currency to equal, and eventually replace, the US dollar. He suggested basing it on Special Drawing Rights or SDRs, an artificial unit of account used by the International Monetary Fund.

That new global currency has yet to be born and the dollar's dominance remains as great as ever. However, China has moved gradually to liberalise its financial and currency policies and has gained the kudos of IMF acceptance of the renminbi as a component in the basket of SDR currencies from late this year. That achievement, a step towards wider acceptance as an international reserve currency, spurred much excited talk about the emergence of the renminbi as a dominant global player and rival to the dollar.

However, a lot else has to happen for that to become a reality. First, in order to ensure Renminbi liquidity, Beijing would need to be willing to run current account deficits for lengthy periods, something it has always resolutely refused to do. Second, it would need to abolish the tight capital controls that prevent money flowing freely in and out of the country. That has always looked like a longer-term exercise, especially as it would need to be

preceded by and sequenced with much deeper and more extensive domestic financial reforms than China has so far undertaken.

Now it looks still more remote. After years of vast capital inflows into China, the tide has turned and money has been gushing out of the country at a worryingly rapid rate. If the flood cannot be staunched, China may face an unenviable choice between devaluing its currency, probably quite steeply, and tightening up capital controls – not relaxing them further.

One last point about those famous foreign exchange reserves is that there is in practice less of them than there appears to be. That is because a sizable chunk – perhaps more than half - is not available to spend freely, because it is invested in illiquid assets, already committed for other purposes or is needed to defend the exchange rate. With capital gushing out of the country, Beijing needs to husband them carefully.

The one area where China does derive influence from its economic strength is in international trade and, specifically, in the right to grant or deny access to its national market, through exports and investment. Foreign politicians and business leaders regularly fall over themselves to woo China in quest of favours: witness the British government's assiduous – some would say shamelessly sycophantic - courting of president Xi on his London visit last year. Other countries also fear offending Beijing in case it discriminates against them economically.

China plays effectively on those concerns to get its way, skilfully deploying divide-and-rule tactics. But in truth, the concerns are exaggerated and a symptom as much of other countries' weaknesses as of China's strength. China's trade and foreign investments nowadays are driven increasingly by domestic need and calculations of commercial interest, not by political favouritism. Other than in the field of civil aircraft, where Beijing has long used its purchasing power to play the US and Europe off against each other, there have been relatively few cases when offending it has incurred serious punishments, and fewer still when sucking up to it has obviously paid economic dividends. Both Britain and Norway, which aroused official Chinese fury for treating with the Dalai Lama a few years ago, have seen their exports to China continue to rise steadily since doing so.

Let me conclude with two other myths. One is that China has never been an expansionist or externally aggressive power. So few people outside the

country believe that, that it hardly seems worthy of comment. How else did the country's land area double between the mid-17th century and today? But Beijing's official mouthpieces repeat the claim so regularly that it is worth nailing for what it is: a gross distortion of history.

Down the ages, there have been numerous cases of China both extending its frontiers by force or venturing far beyond them. In the 13th century Kublai Khan, the first Yuan emperor, invaded Vietnam no fewer than three times, as well as Japan, Burma and Java. In 1950, China sent large numbers of troops into Korea and Tibet, which it later annexed, and into Vietnam again in 1979, when it suffered heavy casualties. And today, Beijing lays claim to much of the South China Sea and is backing its assertion of jurisdiction with naval forces and the fortification of disputed islands.

Beijing's arguments that these expansionary moves are either in self-defence or that it is simply reclaiming territory that has always been China's have convinced few other governments, not least because they are supported neither by conclusive documentary proof nor by international law. However, they have succeeded in raising the political temperature and deepening mistrust of China's motives in many parts of the region.

In conclusion, one last myth - and only a semi-serious one. This is that, the Great Wall of China is the only man-made structure visible from outer space. It is not. Indeed, it is invisible. We have that on the say-so of a Chinese astronaut who reported in 2003 that he couldn't see the Wall from up there at all.