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Wilton Park



Conference report

Towards prosperity: implications and opportunities of the 18th Congress of the Communist Party of China

Sunday 16 – Tuesday 18 December 2012 | WP1196

In association with:

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“China is living through the best of times; the worst of times.”

Key points

- China is shifting the focus of its growth-led economic policy towards social policy.
- Chinese people want the same things as those in the West - better education, a more stable society, higher income, more reliable welfare, improved health care, housing and a cleaner environment.
- Harmonious development rests on meeting the aspirations of a more diverse and demanding population and reducing inequality created by rapid growth.
- The new leadership is seen as more powerful, more purposeful, more reformist and more willing to listen.
- China aims to provide a social security system that covers all – but needs to find a way to pay for it.
- Reforming the *hokou* system, which divides urban and rural dwellers, is a priority.
- China wants to seize the opportunity presented by the change of leadership and press ahead with structural reforms - of state-owned enterprises (SOEs) and the financial and legal systems in particular.
- Chinese companies should expand their overseas presence, enhance their co-operation in an international environment and develop a number of world class operations.
- Ecological concerns are now a mainstream concern incorporated in economic and urban planning.
- Improving the rule of law, and developing its own rules-based system, can help China compete globally and create a more equal and harmonious society.
- The West needs to be modest about its own system and show that democratic capitalism can be both virtuous and effective.
- Both have much to learn from each other but engagement between China and the West may often get harder before it gets easier as both sides adjust to changing strategic and economic realities.
- The key is to manage these differences successfully.

Introduction

1. Within 30 years of opening up – and starting to introduce market reforms – China has grown to be the second largest economy in the world. It is rightly proud of having lifted 600 million people out of poverty and of progress in developing both its society and economy.
2. But the inequalities that have arisen as a result; the growing and disparate aspirations of its people and calls from the outside world for China to assume a more prominent role in global affairs have led to considerable, and conflicting, pressures on the leadership.
3. The difficulties of managing these prompted one Chinese participant to quote Charles Dickens' description of the French revolution and say that China was living through "the best of times; the worst of times".
4. The conference agreed that it wasn't easy to predict how China would develop under the leadership of Xi Jinping - who was confirmed as General Secretary of the Party at the 18th Party Congress held a few weeks previously - and of Li Keqiang who is both China's Premier and the leading figure behind its economic policy.
5. The last 10 years of economic boom had been a "lost decade" in which many problems remained unresolved and crucial reforms did not materialise - and there was no guarantee that the coming decade would be different.
6. Dealing with the disparities of wealth caused by rapid growth; the effect on the environment; the uneven pace of development across the country and the impact of migration to the cities, which created an underclass of people not registered to live there, was far from easy especially now that growth was slowing.
7. China still saw itself as a developing country but faced the pressures of a developed one. The Chinese economy remained out of balance – with an under-developed domestic market and too much reliance on exports. It was "like a jacket made from hyper-fabric but the shirt underneath is covered with patches".
8. But, with the country at a crucial stage in its economic and social development, there were reasons for optimism. The new leadership was seen as more powerful, more purposeful; more reformist and more willing to listen.
9. It was clear that policy was now being driven from the bottom-up and that Beijing had no choice but to reform as a response to China's rapidly changing circumstances. The Central Economic Work Conference had set directions for the future that indicated commitment to a radical reform agenda.

Balancing stability and reform

10. China's aim, the Chinese participants said, was to achieve a "moderately prosperous society" with a greater spread of wealth by 2020. This would continue to be done through "socialism with Chinese characteristics", but whereas, previously, the onus had been on rapid economic growth, there was now a shift towards "putting people first".
11. The concept of the "China Consensus", highlighted at the Party Congress, held some important indicators. It was not the same as a "China model", in the sense of promoting China as an example for other countries to follow. Instead, it signalled a resolve to listen to what the Chinese people were saying.
12. "China consensus means the consensus of China" said one participant outlining five key aspects:
 - Scientific development – planning for China's future through comprehensive, holistic, co-ordinated and sustainable development with heavy investment in science and education. The core aim being to "put people first" by adjusting the economic growth model, continuing with political reform and protecting the

environment to create “not only a prosperous but also a beautiful China”.

- Adopting policies to continue to reform and open up - with particular emphasis on innovation.
- Ensuring stability and harmony. The 18th Party Congress had symbolised this with an orderly change of leadership. At the same time, China would uphold social equity and justice emphasising the rule of law to fight corruption and help maintain social stability.
- Peaceful development, whereby China would not interfere in the internal affairs of other countries; seek “win-win” situations and contribute to strong, sustainable and balanced growth of the world economy through greater co-operation with others.
- Chinese characteristics – China has a history of 5,000 years; is a socialist country and, with 1.3 billion people, is the world’s largest developing country so it could not, and should not, copy other countries but have confidence in its own development path.

13. There was a clear link to recommendations contained in the World Bank’s 2030 report that China should:

- Implement structural reforms to strengthen the foundations for a market-based economy
- Accelerate the pace of innovation and create an open innovation society
- Seize the opportunity to go green
- Expand opportunities and promote social security for all
- Strengthen the fiscal system
- Seek mutually beneficial relations with the world

14. The difficulty identified by the conference was in answering the question of – “whose consensus and on what basis?” – Chinese society was more complex and diverse than at any time in its long history. Divisions between urban-rural; rich-poor; east-west; young and old meant that it was harder than ever before to establish a consensus.

15. And the growing wealth gap, regional disparities in the pace of development, demographic pressures caused by an ageing population, and the tensions on family life resulting from the one child policy were set to increase, rather than diminish, tensions.

16. The answer to the question of what Chinese people wanted was a simple one – they wanted the same things as those in the West.

17. The conference heard a poignant account of a wish tree survey carried out by one participant in Chongqing. With the permission of the Chinese authorities, he put up billboards featuring images of trees, like the “wish trees” in Daoist, Buddhist and Confucian temples where people tie their notes about private desires to the branches.

18. The results showed that they wanted better education, a more stable society, higher income, more reliable welfare, improved health care, housing and a cleaner environment.

19. They also revealed how people had been disconcerted and disorientated as they struggled to reach an accommodation between capitalist-consumer pressures and traditional cultural values. They needed to feel that even if they weren’t beneficiaries now, they would be in the future. And they had a deep yearning for a sense of procedural fairness; a challenge for any centralised bureaucracy.

Towards a fairer system

20. Developing a fairer social security system to cover the whole population was cited during the conference as a top priority for the Chinese government.
21. Reform of the *hokou* system was the starting point.
22. The *hokou* regime, which dates from 1958, has split China's 1.3 billion people along urban-rural lines. There are 890 million people living in Chinese cities – but 220 million are immigrants from the country who do not have city *hukou* and are thus denied access to basic welfare and services.
23. A system of national residence permits, under discussion to replace the *hokou* system, would help to abolish the discrepancy between city and rural systems and enable provision of medical cover and pensions for all.
24. But how would this be organised and paid for? The national lottery was seen as one means to provide funding through a strategic reserve fund that would involve government contributions also.
25. The conference heard parallels between the impact of China's rapid growth and resurgent interest in the teachings of Confucius – and the industrial revolution in Britain which also led large groups of people to migrate to cities.
26. It was the tendency of markets to turn human beings into commodities. As a response, industrialisation in Britain had prompted the rise of organisations such as the co-operative movement, frequently underpinned by religious groups, in which people could find human-scale connections.
27. One of the biggest tasks, looking ahead, was for the Communist Party to adapt to the requirements of a more demanding society. In the past, the task was much simpler – to feed the people. Now, with basic needs covered, their aspirations were higher and more difficult to satisfy.
28. The conference heard that the last decade had seen a threefold increase in incidents of social protest. To achieve harmony, societies needed to find a way of living with tension and the best way of doing this was through some form of politics.
29. This raised issues about the nature of the relationship between the Party and Chinese society. One of the great achievements of the Party over the past three decades has been its ability to adapt to the demands of change. This had been seen with the reform of agriculture after 1978; the economic liberalisation that followed Deng Xiaoping's "Southern Tour" and the reform of state owned enterprises in the second half of the 1990s.
30. But the years of economic growth following the 17th Party Congress had been characterised as a lost decade when more could have been done to introduce reforms.
31. The question, then, was whether the Party could be responsive to change and the demands of a "multipolar society" or, whether it would become more fearful or complacent. If it went down this path it would face a crisis of legitimacy. Ultimately its legitimacy rested on its capacity to deliver.
32. It was crucial to find the right balance between bottom-up and top-down reform. The Party's challenge will be the need to continue to resist the twin temptations of ideological dogmatism and a desire to micromanage the Chinese people while ensuring there are sufficient checks and balances to prevent the abuse of power.

Rules-based systems as a tool for development

33. Rules-based systems provided a useful tool for development. In his address to the 18th Party Congress, China's outgoing leader Hu Jintao had warned that "if corruption becomes increasingly serious, it will inevitably doom the party and the state" implying that reform to political structures was crucial.

34. The conference heard a definition of the “rule of law” as being fundamentally about how power is constrained, in all its forms, to ensure that citizens are free from its arbitrary use – whether by state or non-state actors. Five basic principles need to be observed.
- Citizens are free from the arbitrary use of power and provided with legal certainty.
 - All citizens are treated as equal before the law
 - Accessible and effective justice is available to all citizens
 - Law and order is prevalent so that citizens do not unduly fear that their personal property or security is violated either by agents of the State or by predatory citizens.
 - Human rights are protected both by law and its implementation
35. The conference agreed that reforming the rule of law is not simple – all states are somewhere on a continuum and the five areas do not necessarily move together. A country can improve in one area – such as law and order - and be quite low on others, such as equality before the law, human rights or non-arbitrary use of power.
36. China scores well on public safety and law and order – ranking 32nd out of 97 countries in the 2012 World Justice Project Index. Its criminal justice is seen as relatively effective, though compromised by political interference and violation of due process.
37. However corruption and arbitrariness characterise the administrative agencies. Civil courts are relatively efficient and accessible but judicial independence is a problem; effective checks on the executive are limited and fundamental rights are weak – particularly the freedom of speech and assembly needed for enforcing the rule of law.
38. As China’s wages rise, its currency stabilises at a higher rate and oil costs force manufacturing closer to home, China will need to compete on a more equal playing field with the rest of the world.
39. It has many comparative advantages: an educated workforce, a skilled labour market, people who work hard. Improving the rule of law can help it compete globally and increase the development needed for a more equal and harmonious society.
40. It was stressed that the state alone cannot create the rule of law – it must be an inclusive process with people empowered to help. The state and society could be seen as two wheels of a cart – they must turn together for the cart to move.
41. Reform must begin with the power structure and cannot rest on the good will of individual reformers. Instead, power must be corralled through the structures of vertical and horizontal accountability. Genuine devolution and cutting regulation can help.

The future of democratic capitalism

42. Western participants called for the “need for modesty” with regard to these issues.
43. The greatest single challenge for the West in engaging with China over the next decade is to get its own house in order. Many of the contradictions in Western countries’ reaction to the rise of China were due to their own weaknesses, made manifest by the financial crisis.
44. The issue was not whether the so-called China model was better than liberal democracy, or whether state capitalism, “industrial consolidation” and the “concentration of capital” were better than market liberalisation and the emphasis on small and medium-sized enterprises.
45. The real challenge was different. Western policy-makers found themselves in a position where they needed to demonstrate to their own peoples, as well as to other countries, that democratic capitalism is not only virtuous but effective.

46. China's ambition to double GDP in a decade, and disposable income in the decade beginning 2020, posed real challenges for the European Union with regard to trade policy in particular.
47. But there are many different problems faced by China and the West that need a common approach at the international level. The rules-based system, with its reliance on soft laws, conventions and best practise, had been mainly drawn up by Western powers. It needed the new economic powers to be equally involved; more flexibility in dealing with challenges and the recognition of more common than different challenges.
48. The UK needed to rebalance its economy away from consumer-debt led consumption and growth and to engage more deeply in commercial relationships with other nations. There were considerable differences between them - China was a developing economy; the UK a mature one - but the shape of the Chinese and British economies was set to converge as China shifted from a high-cost labour market to a less expensive one.
49. Britain and China had much to gain from working together – education was one area that presented particular opportunities. There were over 100,000 Chinese university students in the UK. Many British schools have set up sites in China and many Chinese students came to British schools.
50. The Confucius Institutes were increasing knowledge of China and providing opportunities for young people to learn mandarin and engage really effectively with the country and its people.
51. China was seeking to open up the higher education system to promote a greater culture of entrepreneurship and more effective links between education and employers thus providing greater potential for students to choose the right career path.
52. UK schools could learn from the Chinese focus on the sciences and mathematics.

Meeting the needs of an ageing population

53. China's concern about the impact of demographic change also provided an opportunity for China and Western countries to work together and learn from each other.
54. In 2012, 185 million people, or 13.7%, of China's population were over 60 and that is set to rise sharply reaching 487 million, or 35% of the population by 2053 - with a concomitant decrease in the working age population.
55. This is leading to important social change; in 2015 there will be 221 million over 60s, including 51 million "empty nesters," or elderly people whose children no longer live with them.
56. Ability to care for the elderly will decrease; service industry and other sectors will be impacted.
57. China has been looking at developed countries in order to reduce uncertainties and risks.
58. European countries have been addressing these issues by developing policies to promote active and healthy ageing – such as those included in Europe's 2020 strategy to encourage "smart" policies for sustainable and inclusive growth which can help people to stay longer in the workforce.
59. The advantages are manifest in terms of boosted national income, material and physical benefits for those concerned and reduced pensions costs. Sharing information on pension provision is an area where the EU and China can cooperate. China had the largest pension system in the world. The pension and medical insurance systems needed to be better integrated and to provide cover for urban and rural dwellers and migrants also.

Managing migration

60. Balancing migratory flows was also seen as an area where knowledge could be shared.
61. For years, China had had an abundant labour force but the last decade saw a reversal. Where, 10 years ago, there had been 100 people for every 60 jobs; now there were 100 for every 108.
62. Costs were going up and that meant employers did not always register their employees. Countries in South East, such as Bangladesh were supplying labour. But this was creating social tensions and greater demand for public services as well as challenges to China's homogeneous culture.

Catching up

63. China's industrial policy was highlighted as a success with the persistent determination to nurture a large group of globally competitive firms; reform of state-owned enterprises (SOEs) and state industrial policy support for national champion firms in strategic industries.
64. There had been real technical progress in key sectors including electricity generation and distribution, railways, oil and gas, aircraft and banks. China's largest SOEs have made substantial technical advances supported by surging growth in domestic demand.
65. Aviation was a good barometer of prosperity. Before 1974 it wasn't possible to visit China as a tourist – in 2011 there were 135 million inbound tourists to China. China would probably be the world's largest tourist destination by the end of the decade. Beijing was already the second largest airport in the world. "Where there's flying; there's buying," said one participant.
66. There were 70 Chinese firms in the Fortune 500 index, more than any country apart from the USA; four of the top 10 banks in the FT 500 were Chinese including the No 1 Industrial and Commercial Bank of China (ICCB) and No 2 China Construction Bank (CCB).
67. This challenged the Washington Consensus view of transition which argues that rapid privatisation was the only way forward. China's bureaucrats were deeply involved in business but China had caught up with, and overtaken, many of the world's leading firms from most high income countries, including Japan and Germany.
68. But the fact that China's large state owned enterprises have high revenue, profits and market capitalisation does not mean that they are globally competitive firms.
69. China was adopting the concept of social corporate responsibility and heeding calls for the heads of state-owned enterprises to be professional, corporate managers.
70. But there were often strong vested interests fighting against SOE reform even though there had been calls for the cultural change required to recognise that public-private sector partnerships could be the best way to reform.
71. China is more open to foreign direct investment than any other large latecomer country and in sectors open to FDI multinational firms occupy a large share of the Chinese market. Most sales revenue of China's SOEs comes from the domestic market in sectors protected from direct competition with the world's leading firms: banks, telecoms, oil and gas, power generation and distribution, metals/mining and construction.
72. But there was a strong global trend towards industrial and sectorial consolidation with a handful of giant firms occupying up to 50% of the whole global market in sectors ranging from commercial aerospace and automobiles to beverage and confectionary.
73. And Chinese firms have a negligible share of international markets in high/mid-

technology products, branded consumer goods and service industries. This was seen as a remarkable fact for the world's largest economy.

74. China still faced an immense challenge if it was to achieve its goal of nurturing a group of indigenous firms that can compete on international markets and there was no "quick fix" for catching up. The high level of global industrial concentration means that simply changing the ownership structure of Chinese SOEs would not be sufficient to permit extensive "catch-up" with leading global firms from the high income countries.
75. Chinese companies needed to heed President Hu Jintao's warning at the Party Congress that they should expand their overseas presence at a higher rate, enhance their co-operation in an international environment and develop a number of world class operations.
76. Similar concerns applied to the financial system. The price of money was kept artificially low. Reform of the financial system meant that 50% of it was no longer under government control and needed some form of regulation. A shadow system of unregulated credit was in place which had driven interest rate liberalisation and which the government needed to balance in the formal system.
77. The major issue – thirty years of credit misallocation could be transformed to reflect market prices. Liberalisation of the Qualified Foreign Institutional system would also allow more international capital into the system. Furthermore, current rules on the stock-market restrict improvements in generating premiums such as insurance premiums that could help provide welfare.
78. Price reform was also essential, particularly with regard to water and sources of energy such as coal. Current World Bank estimates suggested they were as low as 25% of what they should be.
79. And there were calls for land to be privatised as part of agricultural sector reform. Strategies based on self-sufficiency did not make sense in the context of rising domestic demand.
80. There were ideological reservations about privatising land but it could be done fairly through local government land auctions thus boosting revenue that could, again, be used to fund social welfare.

Towards green growth

81. The need to safeguard the environment and conserve energy had only been recognised in China in the last 10 years but there was now a high level of awareness throughout the population.
82. And the importance of this issue had been recognised by the 18th Party Congress which decreed that ecological protection should be an integral part of economic – and urban planning in particular.
83. Some blamed the West for pollution – "we produce cloth for developed countries and sacrifice our environment" said one participant.
84. But technological innovation in western countries was providing answers – aircraft were now 25% more efficient in their use of energy. The conference heard of other initiatives such as the development of sustainable biofuels using waste material. The challenge lay in turning technological reality into commercial success.

Conclusion

Strategic adjustment

85. Attention given to the 18th Party Congress reflected the importance which the rest of the world gave to the change in China which was deemed as significant as the US presidential election.

86. The rest of the world wanted China's peaceful rise as a responsible stakeholder but definitions of what this meant were likely to vary.
87. It was suggested that the UN should provide the framework and its founding principles be seen as the yardsticks. These included being willing to undertake humanitarian interventionism.
88. It was noted that President Obama had declared that he did not want the United States to be number two in the world. Washington – and others – would, however, need to adjust to changing strategic realities, in particular a global context where power and influence are much more evenly distributed.
89. The West needed to recognise that its capacity to influence, much less dictate Beijing's policies was limited. The global reality required a more balanced and consistent approach to pursuing objectives with regard to China - neither kowtowing nor patronising.
90. One important challenge will be to depoliticize relations as far as possible. Western decision-makers are subject to many different pressures. But it was unfortunate that China had often been used as a political football to pander to various domestic constituencies.
91. Chinese people were no different in their aims and aspirations from their Western counterparts as the conference had discussed.
92. But, at the geo-strategic political and economic level, there would continue to be strong disagreements – whether on national sovereignty versus the international “responsibility to protect”; the South China Sea, visa regimes or on differing conceptions of human rights.
93. At the same time, it was a competitive world in which outcomes sometimes reflect “win-lose” rather than “win-win”. Whether in the Middle East, the South China Sea, international trade policy or climate change, countries have conflicting objectives and interests.
94. It was important to recognise too that the world was not harmonious and that geo-political and geo-economic tensions were increasing.
95. There were times when engagement between China and the West would get tougher before it got easier as both sides adjusted to a fluid and volatile global context and changing strategic and economic realities.
96. The issue is not that these differences should arise. The key is in how they are managed. For this, frank dialogue was essential – and there was gratitude that Wilton Park and the Party School were providing opportunities for such dialogue to take place.

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