Politics are still trump in Chinese global strategy.

CHINA'S CORPORATE *Leninism*

BY JOHN LEE

On December 10, 2003, Premier Wen Jiabao introduced American audiences to the concept of China's "peaceful rise" in a speech to students at Harvard University. Pointing out that China was a poor country in per capita terms and a backward economy in many respects, Premier Wen argued that China needed a stable environment in which to rise. He noted importantly that China is rising within the global liberal economic order, choosing participation over the austere autarky of the Mao Zedong era. China's "peaceful rise" thesis (*Zhōngguó hépíng juéqǐ*), later adjusted to "peaceful development" (*Zhōngguó hépíng fāzhǎn*), seemed to reaffirm what prominent scholars had been saying for years: Even though the liberal economic order was designed and built in the West, it was an open order. Rising non-Western states could prosper within this competitive environment without contesting its basic rules and principles.[1]

The argument that China neither wishes nor is able to undermine and transform the international liberal order is persuasive. China has been that order's greatest beneficiary over the past two decades, and for practical reasons seems locked into it for the foreseeable future. Already the largest trading partner of Japan, South Korea, Vietnam, Singapore and Australia, as well as the largest Asian trading partner of America and India, China cannot afford to remove itself from the global trading regime. More important, perhaps, China has not elaborated an alternative concept to the existing order—certainly not a concept other countries would be remotely likely to follow or replicate. Nor is it remotely likely that China could impose a new order on its Asian neighbors. America remains both the preeminent Asian military power and also the preferred security partner for every significant country in the region. In strategic terms, China remains a decidedly isolated rising power despite its growing military capabilities.

Yet the argument and evidence that China will choose to be *increasingly* integrated into the global liberal economic order, or be persuaded that it should do so, is far weaker. Those who assume an irresistible trend toward greater Chinese integration into the liberal economic order—those persuaded of the stakeholder metaphor coined by Robert Zoellick—critically misapprehend the worldview and priorities of

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[1]See G. John Ikenberry, "The Future of the Liberal World Order: Internationalism After America", *Foreign Affairs* (May/June 2011).

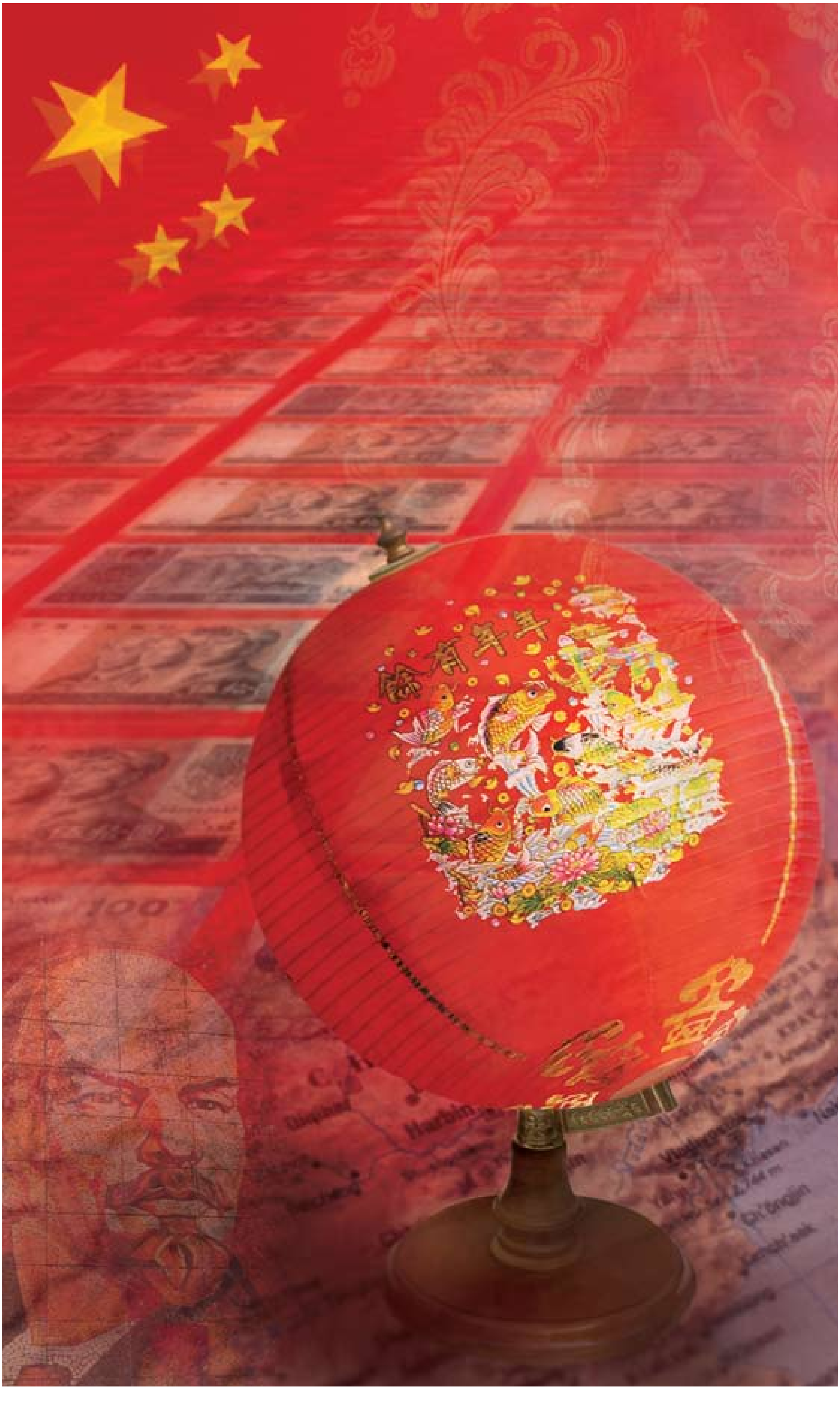

illustration by Lindsey Burrows

the Chinese Communist Party (CCP), and miss the broader implications of how China is actually ruled. They also ignore the political and structural pressures on the CCP to "guarantee" certain economic outcomes for its state-owned enterprises (SOEs), as well as the realities of how political, economic and social relations are conducted between entities in the country's state-led and state-dominated political economy.

In essence, the problem is this: A rules-based system of entities competing against each other through a commercially driven process seeks to circumscribe the role and capacity of governments (and political parties) to intervene in economic activity. It quarantines economic activity from political interference by governments to the extent possible, and it allows the logic of commercial rather than political interests to play out. It respects ordered but genuine markets. The CCP ultimately seeks opposite ends.

To be sure, liberal democratic governments have an intrinsic political stake in the outcome of economic competition. However, successfully engineering a predetermined economic outcome (through securing expanded opportunities for its SOEs, and guaranteeing resources for its fixed-investment led economy) goes to the very survival of China's authoritarian regime. The upshot is that genuine integration into the global liberal order would demand significant modifications to the Chinese political economy—and to how China is ruled—that could fatally weaken the relevance of the CCP and fundamentally threaten the Party's tenuous bargain with China's economic and social elites. Since retaining power remains the CCP's paramount priority, Chinese economic entities, especially those directly owned by the state, remain latent tools not just of statecraft but also of regime security within its evolved "Leninist worldview."

Given that Chinese SOEs face significant operational and cultural barriers to success in the global marketplace, the CCP is unlikely to leave their fate to the gods of competition, competence and chance within the hurly-burly of a rules-based market system. In other words, the perceived political, economic and strategic costs of genuine integration into the global liberal economic order are far higher for the CCP than the largely transactional costs of free riding within that order.

Pillars of the Global Liberal Order

It is common to observe that the pillars of the modern international liberal order include a system characterized by rule-based competition and dispute resolution processes, and open economic and trading systems. But what these rules imply for the role of governments, for the diffusion of power and for the practice of domestic and international politics is much less often discussed and far less well understood.

Within a liberal order, governments must commit to upholding a system of global economic rules, an agreed framework for economic cooperation and competition, and processes of dispute resolution that are not supposed to predetermine eventual economic winners and losers. For example, the constabulary responsibilities of the American Seventh Fleet in the Indo-Pacific can have no bearing on the operation or outcome of economic activity in the region. Washington can legitimately use its material power to protect its citizens abroad but not to strong-arm foreign governments or firms to achieve desired economic results. We are beyond the mercantilist war system, and getting beyond it was indeed one of the ideological pillars of the American Revolution.[2] In policing the system rather than primarily engaging in economic and trade competition themselves, governments substantially forfeit their capacity to engineer economic outcomes. In other words, an international liberal order implies a clear separation between political and economic agency and agents.

The separation of political, economic and legal and administrative agency, and the subsequent diffusion of power it creates, are of course foundational features of domestic political order in modern liberal democratic systems. Individuals can bring actions against the government, with legal judgments determined by independent courts and judges. The ultimate manifestation of the rule of law in operation in any polity is the peaceful removal of a serving government following an election defeat, which mandates that it relinquish all capacity to use state assets to coerce its way into future

[2]Note Felix Gilbert's justly famous book, *To The Farewell Address* (Princeton University Press, 1970).

incumbency. These are structures and habits of behavior vital to the genuine operation of both a domestic and an international liberal order. In the latter, this order is made possible by the seminal fact that governments voluntarily enter into this arrangement (and regimes within it such as the World Trade Organization). It is no coincidence that the Western keepers of their domestic liberal orders have extended a parallel expectation for membership in the international liberal order. Westerners may not explicitly recognize this parallel, so natural does it seem to them, but the CCP elite certainly does, and they well understand the edgy implications of the connection.

To be sure, authoritarian regimes can participate in a liberal global order without their domestic regimes being decisively implicated as a consequence. Japan in the late 1940s and South Korea and Taiwan into the 1980s were authoritarian regimes rising within the post-World War II liberal order. But all these countries were nestled within the Western alliance and relied on the U.S. security umbrella, meaning that authoritarian governments in these countries were far more susceptible to American pressure for political and economic reform than China is today. Partly in consequence, by the end of the 1970s the rule of law, firm property and intellectual property rights and independent bureaucracies were far more deeply established even in still-authoritarian countries than they are in China today. Once genuine democratization occurred in these countries, they became truly integrated into the liberal order and vocal champions of it. None of these circumstances or developments applies to China.

Finally, the frequently intoned line that modern China is simply following the "East Asian model of development" is also highly misleading. As the economic models of other East Asian countries evolved, barriers against greater integration into the liberal order weakened. Given the politics-first structure of the Chinese model of political economy, China is becoming more hostile to key elements of what integration into the liberal order would entail. Although China will continue to participate in the liberal order, the CCP is very unlikely to seek genuine integration and assimilation into it for fear of fatally undermining its domestic strategy to remain in power.

China's Two Distinct Reform Periods

We can understand better the relationship between domestic politics and China's global orientation if we examine closely the nature of Chinese reforms in the post-Mao era. These reforms can be divided into two distinct periods: the pre-Tiananmen period from 1978–89 and the post-Tiananmen period from 1991 to the present.

The first period began under Deng Xiaoping in December 1978. Prior to 1989 the unplanned spontaneous explosion of private initiative in rural China, largely fuelled by land reform, was encouraged by officials and even supported by government policy. Farmers were encouraged to make their own decisions about how to use their plot of land (even if it was still owned by the state) and were allowed to sell their produce at market prices after meeting production quotas. A happy accident of the limited land reforms was the spontaneous rise of small-scale businesses known as Township and Village Enterprises (TVEs), mainly in rural China. TVEs were the result of collusion between local officials and rural workers. Local officials were given incentives to remove bureaucratic roadblocks since TVEs contributed to local budgets. As Deng admitted in 1987, "the result was not anything I or any other comrades had foreseen; it just came out of nowhere."[3] Employing fewer than 30 million people in 1980, TVEs were providing jobs for around 140 million by the early 1990s.

Significantly, TVEs helped give decisive momentum to Chinese industrialization. During this decade, mean wages and household incomes were rising at the same rate or faster than GDP growth. An independent middle class was emerging in China. Indeed, 80 percent of the approximately 400 million people who have been lifted out of poverty since 1979 were thus lifted in the first decade of reform (1978–89.)

Due to the emergence of China as the central hub of regional and global trade, many Americans attached special significance to Deng's famous post-Tiananmen 1992

[3] Deng quoted in Michael Ellman, *Socialist Planning,* 2nd Edition (Cambridge University Press, 1989), p. 72.

Southern Tour of the most successful Special Economic Zones, such as Guangzhou and Shenzhen. To be sure, this helped accelerate the Pearl River Delta area as the hub of Chinese manufacturing, particularly for the export sectors. More broadly, many believe that the Southern Tour—encapsulated by Deng's alleged aphorism, "To get rich is glorious"—was essential for ensuring that China continued to open up rather than return to Maoist thought and economic autarky. This interpretation is incomplete, however. Even as Mao's communism was decisively abandoned, the enduring and more significant legacy of the countrywide protests in 1989 was the rise of Chinese "state corporatism", a development that went beyond anything that ever occurred in the other successful East Asian economies.

The 1989 upheavals were far larger than most Americans and other outsiders appreciate. Most foreign observers see only events in Beijing, but there were thousands of protests in around 350 cities, involving millions of people. After a period of political introspection, the CCP decisively changed tack, its thinking affected dramatically by the fall of the Berlin Wall and the subsequent implosion of the Soviet Union. As Chinese leaders and scholars analyzed their circumstances, they concluded that in addition to maintaining the Party's extensive coercive apparatus, the future well-being of the urban middle-classes needed to be intricately tied to the CCP one-party system. In a rapidly industrializing system, the Party faithful realized, urban elites determined the fate of authoritarian governments. The great lesson of the East European and Soviet revolutions learned in Beijing was that authoritarian regimes become irrelevant to their own elites at their very considerable peril.

The CCP plan to retake the levers of economic power and privilege was cobbled together from the mid-1990s onward. In essence, it involved further expansion of the private sector and a sharp reduction in the number of centrally managed SOEs, but it also reserved around a dozen of the most important and lucrative sectors of the economy for SOE dominance. These sectors include banking and finance, insurance, construction, infrastructure, chemicals, media, information technology and telecommunications. Although foreign direct investment was encouraged in the export-manufacturing sectors, it was deflected away from these core, politically sensitive sectors. Even China's own private domestic companies were deliberately disadvantaged in terms of access to markets, capital and land in these core sectors. Here the state would maintain political control through the state-owned enterprises, which would in turn guarantee both elite loyalty and revenue for the CCP.

Today, there are approximately 150 centrally managed SOEs and 120,000 provincial and locally managed ones in China. When SOE subsidiaries are included, there are probably twice that many. Compare this number to the approximately four million private corporations, and tens of millions of small, informal private businesses, and it might seem, on the face of it, that China appears to be a success story driven by the private sector. Upon closer inspection, however, the return of the state in the Chinese political economy is evident from several measurements and other observations.

One measure, which traces the flow of capital, is particularly revealing because it shows that domestically funded fixed investment (basically, building things) is the dominant driver of Chinese GDP growth. From 2001 to 2008, it was responsible for about 40 percent of growth. In 2009, due to the massive stimulus ordered by the government, between 80 and 90 percent of growth was the result of capital investment, dropping to levels of about 50–55 percent of growth currently.

China is unusual in that bank loans, drawn from the deposits of its citizens and funneled into state-controlled banks, constitute about 80 percent of all investment activity. China has very underdeveloped equity markets for such a large economy. State-controlled banks dominate the formal finance sector, while private domestic and foreign banks constitute only between 2–5 percent. The sharp bias toward the state-controlled sector is clear from the relationship between these state-controlled banks and China's industrial SOEs.

Even though state-controlled enterprises produce 30–50 percent of all output in the country, they receive more than 75 percent of the country's capital, and the figure is rising.[4] SOEs received more than 95 percent of the stimulus monies lent out in 2008–09 and an estimated 85 percent in 2010. The State-owned Assets Supervision and Administration Commission (SASAC) indicates that the assets of SOEs amount to more than 66 percent of all assets in the country, up from 60 percent in 2003. This is the reverse of what occurred in China during the first ten years of reform, when the majority of new fixed assets were effectively controlled by the emerging private sector. Even if they were formally "community" enterprises, the plain truth is that private sector businesses received more than 70 percent of all the country's capital.

Indeed, according to the Chinese National Bureau of Statistics, an analysis of the economy by sector shows that state-controlled entities invest more in almost every major sector in urban China than do private companies. The only sector dominated by private industry is manufacturing, a sector dominated by foreign-owned or foreign-invested export-manufacturing firms.

Moreover, it is generally treated as a strategic priority for state-owned enterprises to dominate every emerging sector that becomes important to the modernizing Chinese economy. For example, the SASAC's *Guiding Opinion on Promoting the Adjustment of State-Owned Capital and Reorganization of State-Owned Enterprises*, issued in December 2006, expanded strategic sectors to include civil aviation, auto industries and shipping in addition to the dozen or so sectors previously designated as critical. According to the *Guiding Opinion*, the state was to maintain a majority ownership stake in every major firm in those industry groupings. Although the State Council did not formally ratify this document, it remains the *de facto* guiding framework for these emerging sectors. Indeed, the *12th Five-Year Plan (2011–2015)* released in March 2011 explicitly states that "national champions" are to take the lead in "strategic emerging industries" such as renewable energy, healthcare, biotechnology, high-end equipment manufacturing, energy-efficient vehicles and information technology. It is clear in the plan that the government is to "channel state capital into industries pertinent to national security and the economy through discretionary and rational capital injection or withdrawal." This includes both resources from the formal fiscal budget but also, more importantly, loans from state-owned banks.

Other measures are also telling. For example, the 2009 *China Statistical Yearbook* reveals that state-controlled entities accounted for more than half of all total wages paid to urban employees. Not surprisingly, this corresponds with another finding that almost half of all tax revenues received by the government is from state-controlled entities.

Finally, it is illuminating that the corporate giants emerging from China are almost all state-controlled enterprises. All but approximately a hundred of the 2,037 firms listed on the two Chinese stock exchanges are majority owned by SOEs. The ten largest Chinese firms ranked 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. Indeed, the revenues of the top 20 centrally

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[4]The precise figure is difficult to determine because of the lack of transparency of shareholding and ownership in Chinese enterprises. Although the term SOE is commonly used, many of these enterprises are majority-owned rather than wholly owned by the state (with shares held by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC). Additionally, many state-controlled companies hold majority or controlling shares in many Chinese enterprises that are nominally categorized as "private" companies. If we include all wholly and majority-owned enterprises in our definition of "SOE", then the proportion of GDP produced by SOEs each year is closer to 50 percent.

managed SOEs amount to more than half of China's GDP each year.

Politics Is Trump

The size and the role of the corporate state in China thus far exceed anything that occurred throughout the postwar decades of state-led "authoritarian development" in Asia. The key to understanding the differences between, say, Japan's MITI-administered industrial policy and what is going on in China is that other Asian states did not deploy business profits to entrench a single-party political system; in those societies, the rise of a genuinely autonomous class of economic elites was accelerated by rapid industrialization in these other countries. The reverse has occurred in China.

Having shown the dominance of the state in the Chinese economy, it remains to be illustrated how an elaborate network of political and economic power links the CCP to Chinese state-owned enterprises. Indeed, the structure of the current Chinese political economy is specifically designed to ensure that the CCP remains the dominant dispenser of commercial, business, professional and even social opportunity. The aim is to tie all privileges and opportunities for Chinese elites to Party discretion. While the operation of a domestic and international liberal order is designed to weaken or at least moderate favored relationships between the political interests and objectives of the government on the one hand, and economic activity, on the other, state corporatism in China is calculated to achieve the opposite. The CCP takes the fundamentally Leninist view that economic entities and activities must reinforce the economic influence and subsequent political power of the regime. Such entities and activities may not support political opposition in any form.

Finding inspiration in Karl Marx and Vladimir Lenin, the CCP was once defined by an ideological hatred of capitalism. That tumultuous Marxism is long gone, buried alongside Mao Zedong and his murderous associates. But while the CCP's Marxism is gone, its Leninism persists, and the SOE-CCP arrangement that developed after Tiananmen now resembles a patronage system not unlike the political-economic structural relationships characteristic of regimes like Mussolini's Italy, Kemalist Turkey and Franco's Spain.

This is evident in a number of ways. Although China's SOEs are called upon to nominally behave as profit-making entities, they are viewed ultimately as instruments of the regime. This is clear from the structure of authority in the Chinese system. The shares and therefore assets of SOEs are held by the SASAC, which takes instructions from relevant ministries. Further up the chain, the SASAC is controlled by and answerable to the State Council of the National People's Congress, China's peak administrative and legislative body. This structure is replicated for provincially and locally managed SOEs. In effect, then, it is the CCP that monitors and preys financially upon the SOE sector.

That China's state-owned firms remain instruments of CCP power is illustrated by the links between SOE executives and the CCP. Meticulous research by Minxin Pei has revealed that the senior managers of all central state-owned enterprises are almost all senior CCP members.[5] The three most senior positions (Party Secretary, Chairman and CEO) of the fifty centrally managed SOEs are appointed directly by the CCP's Central Organization Department (COD). The current head of the COD is Li Yuancho, who also sits as a member of the Politburo. Almost all appointees are CCP members, and in many cases, the CEO and Party Secretary within the company is the same person. Many of the appointees at these levels were formerly top-level provincial officials. All remaining senior executive appointments are controlled by the SASAC, which consults with the COD. Once again, the process for appointment at these senior levels is replicated in provincial and local SOEs. If there were ever an example of an interlocking directorate, this is it.

These findings align with those of a more recent investigation by the Hong Kong-based economic consultancy Asianomics in its September 2011 report, *Inside China's Corporations*. In an extensive investigation into the backgrounds of senior executives at China's ten largest firms (nine of them state-controlled) and their subsidiaries,

[5]Pei, *China's Trapped Transition* (Harvard University Press, 2006).

the report found that the senior executives of all these firms were CCP members, with many having held provincial political office. In tracing the senior management of the next twenty biggest firms and hundreds of their subsidiaries, the report showed that many state-owned firm directors and supervisors have spent some time within the Central Organization Department. As the report concludes, the roles of SOE Chairman and CEOs are "synonymous with the Party."

Even though state-owned enterprises fiercely compete among themselves for market share and profits, evaluation committees staffed by political officials are authorized to evaluate the extent to which senior managers have successfully implemented government strategic and commercial directives. State Council committees periodically scrutinize parent company SOEs for how well they have implemented government policy initiatives and directives. Therefore, even though competition among SOE executives is intense, and increases in revenues and profits are important criteria of their performance, the yardstick used to assess executives is nevertheless ultimately determined by political rather than commercial interests.

To give a sense of what China's Leninist corporate structure really means, we can rely on *Financial Times* journalist Richard McGregor:

> The best way to get a sense of the job [of the Central Organization Department] is to conjure up an imaginary parallel body in Washington. A similar department in the U.S. would oversee the appointment of the entire U.S. cabinet, state governors and their deputies, the mayors of major cities, the heads of all federal regulatory agencies, the chief executives of GE, Exxon-Mobil, Wal-Mart and about fifty of the remaining largest U.S. companies, the justices of the Supreme Court, the editors of the *New York Times*, the *Wall Street Journal*, and the *Washington Post*, the bosses of the TV networks and the cable stations, the presidents of Yale and Harvard and other big universities, and the heads of think-tanks such as the Brookings Institution and the Heritage Foundation.[6]

Finally, the make-up of the CCP's 80–85 million members is instructive. Workers and peasants now account for less than one quarter of members. In modern times, successful businesspeople, professionals and students with higher-level degrees make up more than three quarters of the membership. For college graduates who are also CCP members, their member number is one of the first things they put on their résumés. Another 80–100 million people have applied to join, the majority coming from the aspiring middle and elite classes. They are open about their desire to join in order to get ahead in business and their career. Such anecdotal evidence strongly reinforces the point that the modern Chinese political economy is designed to ensure that the CCP remains the dominant dispenser of opportunity, meaning that the future of the elite classes is, at least for the time being, tied tightly to the future of the Party.

Corporate Leninism and the Liberal Order

In 1997, Bill Clinton publicly made the case that economic liberalization in China would undoubtedly "increase the spirit of liberty over time . . . just as inevitably as the Berlin Wall fell", and rather brazenly told then Chinese President Jiang Zemin at a press conference that "you're on the wrong side of history." Two years later, then-presidential candidate George W. Bush declared in making the case for trade with China that, "Economic freedom creates habits of liberty. And habits of liberty create expectations of democracy." President Bush reiterated the same logic in 2005 when he declared that a "whiff of freedom in the marketplace (in China) will cause there to be more demand for democracy." Most recently, President Barack Obama declared in reference to China that "prosperity without freedom is just another form of poverty" and that non-democratic forms of government will fail because "they ignore the ultimate source of power and legitimacy—the will of the people."

America's post-Cold War Presidents (and their busy speechwriters) do not stand alone in these beliefs. Since the collapse of the Soviet Union, it has been an article of faith for many

[6]McGregor, *The Party: The Secret World of China's Communist Rulers* (HarperCollins, 2010), p. 72.

Americans that China's participation in the global liberal order will lead eventually to China's integration and assimilation into that order, necessarily accompanied by domestic dismantling of its authoritarian structures. The logic assumes an inevitable and increasing divergence between political and economic agency, interest and activity within China. It assumes that in the end the CCP will prove powerless to prevent (or else is unwittingly allowing) the emergence of a powerful and independent economic class that will lead to an ever widening gulf between economic and political power within China. The plurality of powerful interests and interest groups detached from the Party, it is believed, will force the authoritarian political order to decompress.

These presumptions are based on an extremely narrow understanding of possible political-economic arrangements. It is a characteristic of the denatured Enlightenment mentality to think that the way the West developed in this regard essentially fell from the sky as the only logical possibility. It is this same mentality, in even more primitive form, that insists that democracy and open markets are the universal default drive settings for all human communities, regardless of historical experience. This way of thinking discounts the ingenuity of human beings to devise new paths to very different endpoints. It is blind to the fact that the structure of the Chinese political economy today is consciously designed to resist the transformative effects of participation and eventual integration into a liberal order.

As far as the CCP is concerned, participation in the existing liberal order is necessary for China's continued development, but is also the Trojan Horse that the axis of liberal democracies use 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.

Three critical implications flow from this analysis. If the projections based on these implications turn out to be accurate, they will serve as confirmation of this analysis.

First, *China will continue to deny meaningful market access to foreign firms in "strategically critical" economic sectors*. Since the CCP takes a heavily conflated view of political and economic power, "strategically critical" economic sectors tend to encompass every sector important for the development of a modern Chinese economy—even if there are no explicit "defense of the realm" aspects to them.

Furthermore, the deep conflation of political and economic interest means that the CCP views economics in politically competitive terms: A greater economic foothold for foreign (especially Western) firms in "strategically critical" Chinese markets necessarily implies a loosening of the Party's grip on domestic economic, and therefore political, power. This explains why China's "indigenous innovation" drive, the purpose of which is to lessen reliance on foreign firms for innovation, is conducted almost exclusively via the SOEs. Allowing foreign firms to operate at all in "strategically critical" sectors of the economy is predicated on hastening technology transfer and know-how, both to be achieved by the joint-venture structure China will continue to insist on.

Second, *Chinese foreign policy will continue to align with the resource needs of key state-owned enterprises*. Although even U.S. administrations assist specific economic sectors or firms in their global dealings with tax advantages, subsidies and other means, none has ever linked so closely foreign policy behavior with its choice of industrial or financial "winners." Over the past decade, Beijing's "going-global strategy" has been designed to secure guaranteed access to resources, obtain advanced technologies and create or expand markets for Chinese SOEs.

That insight goes a long way to explain Chinese foreign policy in Afghanistan, Iran, Sudan, sub-Saharan Africa and elsewhere. Figures for 2006 reveal that SOEs were behind four-fifths of outward foreign direct investment, with centrally managed SOEs alone behind two-thirds of all outward-bound FDI. State firms are behind more than 90 percent of all non-financial investment overseas.[7] All large investments by Chinese companies over $300 million in the resources sectors and over $100 million in other sectors require explicit approval by government agencies. In

[7]See Derek Scissors, "Testimony to the United States-China Economic and Security Commission", March 11, 2011.

practice, once a Chinese SOE identifies a potential opportunity, senior executives seek approval from political officials. If approval is granted, then SOEs are offered all necessary financing to complete the deal, and directions to help go out to the Chinese Foreign Ministry as necessary.

Finally, *the CCP will remain willing to massively misallocate capital for political purposes*. Major Chinese firms are weak and insecure in terms of corporate structure. They depend on cheap and often free credit, operate in protected markets, and frequently are run at the mercy of professionally incompetent political insiders. They thrive in a corporate culture in which economic success is often based more on political connection and maneuvering than on economic efficiency and innovation.

This is why, despite their advantages in size, the largest and most efficient centrally managed SOEs suffer in comparison with global competitors and private domestic firms. Studies consistently show that even China's largest SOEs perform two to three times worse than domestic private Chinese firms on measures such as profitability, return on assets, return on equity, return on sales and total factor productivity.[8]

The poor performance of Chinese SOEs is even more pronounced when compared with private foreign firms.[9] The return on equity for China's top 500 firms (dominated by SOEs) is approximately 40 percent poorer than the average of the Fortune Global 500 companies. Even as China's economy shows significant growth, these deficiencies will not disappear. The quality of the Chinese economy in terms of corporate governance will not track upward with mass standard economic statistics.

It is tempting for some Westerners to think that universal principles of political economy can explain Chinese realities. For those of a more philosophical, historical or social-scientific bent, on the other hand, it is tempting to look for the Chinese difference deep in history and culture. That might be a fruitful endeavor, so long as it avoids essentialism—the insistence that all Chinese think a certain way. But there is a simpler route to insight than either of these alternatives.

Arguments holding that China's Confucian culture is incompatible with liberal domestic transformation and international integration are unnecessary even if in some respects they prove to be correct. After all, societies with similar traditional characteristics in Taiwan, Japan, South Korea and even Singapore have largely disproved that thesis. Rather, Lenin has more to do with China's course than Confucius. Whatever explains the Chinese difference, Americans and others should accept the reality that China is too important to ignore, too big to intimidate and too formidable to browbeat. It will not march along a well-trodden path to some inevitable destination, just because Western observers are too intellectually lazy or culturally smug to imagine other possibilities.

[8]For a recent summary of relevant literature, see Shaomin Li, Yingchou Lin and David D. Selover, "China State-Owned Enterprises: Why Aren't They Efficient?", Old Dominion University, July 16, 2010.

[9]See *A Report on the Development of China's Enterprises 2007* (Enterprise Management House, 2007).