



POLITICAL SEISMIC
SHOCKS IN CHINA

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IMPLICATIONS FOR IMD CLIENTS

By Professor Jean-Pierre Lehmann – April 2012

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The impact of the political seismic shock in China following the purge and subsequent arrest of former Chongqing mayor and senior party official Bo Xi-lai and the accusation against his wife for suspected murder cannot be underestimated, let alone brushed aside, by anyone with an interest and especially an investment in China. As analysts have commented this is the biggest shock China has experienced since Tiananmen in 1989.

It is very difficult to provide any sort of compelling analysis at this stage let alone assess the possible consequences. Well before the arrest, two things were reasonably clear: the Chinese Communist Party is experiencing considerable tension between two basic opposing factions, one of which may be termed the “reformists” – who basically believe China has to reform, among other things to save the Party – and the other reactionaries (of which Bo was held to be one) who want to maintain things as they are, especially their privileges, or indeed bring the agenda on some reforms backward.

The main lesson, however, is to re-enforce the point that must never be forgotten: of all the major nations today, say members of the G20, Chinese polity is the most opaque, even including Russia. There are paradoxes and anomalies in every country, but in China they take on a quite surreal dimension. The fact, for example, that China is the world’s biggest market for luxury goods and that red Ferraris are a common sight while being still, in per capita terms, a quite poor country is in itself perhaps not that extraordinary. But the fact that it is the world’s biggest luxury goods market + a poor country + a Communist state = somewhat unique, to say the least!

The rest of the world depends a lot on China. It has been for some years, especially since 2008, and remains the main engine of global growth; it has the world’s largest amount, by a couple of \$ trillion or so, of foreign exchange reserves, a good deal of it held in US bonds; it is the biggest trading partner of many countries, not only in Asia, but also in Latin America, the Middle East and Africa; it is at the very core of the global supply chain; China has been disbursing more loans to developing countries than the World Bank; Chinese tourism has become a major source of revenue in many countries, notably in France where the Chinese currently rank as the second biggest spenders, soon to become first; etc; etc. And of course many companies have invested huge amounts in the Chinese market in anticipation of growth and profits.

That a poor country, until less than a generation ago in isolation from the rest of the world community, in a state of economic autarchy, with what by any criterion is a rather obscure political system is also the second biggest economy and second most important country in the world is quite emphatically the most striking – and intriguing – feature of the early 21st century. When you do scenarios or risk analysis for most countries the scope and parameters are reasonably well defined. Take the other Asian giant, India: following a heady period of exuberant growth, India is going through some rather trying times at the moment at every level: political, economic and social. Whether this is a blip and it will soon resume its ascending trajectory or in fact it is more of a break remains to be seen and plausible cases can be made for either narrative. But there are a priori no extreme scenarios for India. Though there is, as we know, quite a lot of skulduggery in Indian politics, nevertheless by virtue of being democratic it is reasonably open and information is reasonably easily available.

China is a different cup of tea!

China is put in different categorical bags, all of which, in my opinion, are unsatisfactory. It is cited as an Asian power, as one of the “emerging economies”, or indeed one of the “BRICS”. Yet the more I observe China in recent years and look with some amazement at the ostentatious display of wealth, the concentration of central power alongside deeply entrenched provincial vested interests, the huge gaps in living standards and inequality, the often flagrant injustice and arbitrary abuse of power, I find myself more and more finding the closest parallel with the French “*ancien regime*” before 1789, ie a nation in pre-revolutionary state.

Against that perspective, there are many others: the growing middle class, the huge number of Chinese students studying abroad, the tens of millions of overseas tourists, the flowering of local arts, the rapid rise in religious observation and conversions, the laying of world-class infrastructure, and the sense of optimistic engagement that one can feel in sectors of Chinese society.

Given China's importance and weight in the global economy and community, we have no choice but to take China seriously. As I wrote recently: [China is not an option, it is an imperative](#). Taking China seriously means, among other things, not only investing in knowing and studying the country, its economy, history, culture, society, but also recognising the complex mosaics that make up Chinese society.

While the contradictions in China and the nature of the political system will continue to generate tensions and conflicts, in the longer term I am cautiously optimistic that it will evolve to a more open, more pluralistic and more liberal society. All of my Chinese friends who are members of the party repeatedly stress the absolute imperative not only of economic reform, but also social and political reforms.

We have to hope they succeed. But we must also not base our strategies on naïve wishful-thinking. Almost literally anything could happen in China and hence one must be prepared for multiple possible contingencies. We should also be pressuring our political leaders to make the overall global environment more conducive to collaboration rather than confrontation with China, in areas such as trade, finance, environment, climate change, health, security, etc.

So the message in respect to China is to watch this space and to watch it very closely with a well-informed and open mind. And be prepared for surprises!

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