

VIEW FROM SHANGHAI



China is getting back to normal after its most important political set-piece meeting in a decade. The 17th Congress laid out the road map for the country's medium term development and in the process showed that political risk in China continues to fall from the highs of the 1960s.

New Politics: Enter The New Master

Investors rarely think about political risk in China because the short-term looks rock solid and the long-term seems unfathomable or unthinkable. This is a mistake.

Now that the world's most valuable company by market capitalisation is, doubtless only temporarily, in PetroChina, and foreign investors are flooding in to Hong Kong's H share market, it is worth taking stock of political risk that faces investors.

China has changed radically since the days when no foreign investor in his right mind would contemplate investing there. That is only 40 years ago. When I first visited China 30 years ago I saw a country going back to work but there was no sign of the changes that were to build year after year for the next three decades.

Clearly China has overcome many obstacles and challenges to reach the point where it is seen as a re-emerging force, both economic and political. However there are still many issues ahead that will have to be addressed before it can match the more developed emerging markets for political stability.

The main foreign media news out of the 17th Congress was that there was no major news. No surprises, no major battles, no effective resistance to Hu Jintao and no new policies: *but that was the news*. The dog that didn't bark.

The *New York Times* tried to make out that there was a battle going on between President Hu Jintao and forces aligned with former President Jiang Zemin as if this was the 1960s, with Mao taking on his critics and about to launch the Cultural Revolution. Good copy but way off the mark considering the outcome.

Jiang's main flag-bearer retired and Hu managed to get his ideas enshrined in the party's philosophical canon, giving him a much stronger hand for the next five years. There was plenty of horse trading as well

as give-and-take, but over fundamentals and who is ultimately in charge the incumbent came out clearly the winner.

What was generally missed was that Hu Jintao seems to be becoming the master of the new politics in China. No more is China ruled by a strongman. Power is much more diffused than it was under Mao, Deng or even Jiang Zemin and Zhu Rongji. Now decision-making is much more consensual. The challenge today is to manage and lead the consensus so as to avoid being trapped and bogged down by it. So far Hu Jintao seems to have shown that he understands all this.

Hu did not exclude his rivals. Instead he has put together an alliance whose constituents are increasingly dependent upon him. From the party elders who attended the Congress in unprecedented numbers, to the princelings who gained some promotions but no blocking vote, to the provincial leaders, some of whom advanced to the centre, Hu has cut them in rather than cut them out.

Hu has a much greater grip in his second term than in the first where he was still surrounded by Jiang Zemin's men. Half the candidates filling the party secretariat and provincial governorships in the key provinces harken from Hu's power base in the Communist Youth League

Talk of Jiang Zemin's remaining power should be judged by the retirement of Jiang's Karl Rove, the very capable Zheng Qinhong. Zheng's talents are likely to keep an important role for him in the affairs of Hong Kong, Taiwan and Japan, where Hu needs him but he is no longer a threat to Hu. Jiang Zemin could not even get his former head of security reelected as a delegate from his old bastion of Shanghai.

Political terms in China are the reverse of those in parliamentary democracies. In the latter, leaders win a mandate, have a honeymoon during which

they try to implement their ideas and then lame duck status beckons. In China it is the reverse, or at least has been for the last two leaders.

Hu's two-term rule is likely to divide into two halves. The first half was all about drawing up policy and consolidating his position (from being in a minority of two in the Politburo Standing Committee).

This he did first by effecting the full resignation of Jiang Zemin, who had remained as head of the powerful Central Military Commission. Then Hu started extending his influence through the military, step by step in what has been alluded to as a Maoist guerrilla campaign. By the time the 17th Congress arrived in October he had appointed all the regional military heads and political commissars, who of course are beholden to him for their rise.

Strong But No Strong Man

Notwithstanding what some commentators have said, Hu Jintao is strong, relative to the times in which he operates. Otherwise how could he have arranged for the 17th Congress to enter his concept of Scientific Development into its philosophical canon, a major achievement?

Hu can use this to push through policies over the next five years for entry into the Party's canon makes it almost holy writ. In contrast, a supposedly stronger Jiang Zemin could only get his Three Represents Theory entered just before he stepped down.

Furthermore Hu felt strong enough to push the most peaceful policy proposal ever to resolve differences between Beijing and Taipei, highlighting their connected blood, same fate and a shared destiny. Out went the threatening language which he would have to have included if he were under any pressure.

Just as Deng Xiaoping did not push for his choice of successor to Jiang (Hu was not Deng's first choice though he soon endorsed him rather than provoke a confrontation) so Hu did not force Li Keqiang on delegates as his successor. The important thing is that Hu went with the consensus. He did not dip into his political capital to fight it.

Policy Decisions Ahead

Decisions are about to flow, judging by statements made at the Congress. From telecom restructuring to the environment it looks as if some of the decisions that have been held up will soon be made.

Implementation of decisions will be helped by the ties of the recently appointed leaders. Xi Jinping and Li Keqiang, the two appointed above all others of the Fifth Generation and seen as taking over in

2012, have experience in major regions: Shanghai and Zhejiang and Henan and Liaoning respectively.

Hu's main priorities remain unchanged:

- sustainable growth
- reducing the income gap
- improving the environment
- stemming corruption
- party reform
- greater global engagement
- improved Taiwan relations

What has changed is that Hu will have more tools to deal with these problems than he had before. Not only has he entrenched his central ideas he has added renewed emphasis to the key ones.

This slight change in emphasis has positive implications for the market. Seemingly elevated above the Harmonious Society to the number one priority is Scientific Development. Shorn of the semantics this means the rational use of resources. Obviously duplicate investment by rival government entities is a target, so is the reduction of waste in raw material usage.

New targets were set for growth. Not only must it be sustainable, senior officials will no longer be judged just on GDP growth, employment and investment alone in their areas but on key measures on the environment and social indicators from health to education. Per capita GDP, as opposed to just GDP, is now set to quadruple by 2020.

Most interestingly, as this has not been mentioned before, 2020 is the year by which China is seen as being industrialised. If so, that implies a great deal of growth between now and then. Less talk of overheating can be expected except where it is fully justified, causing less concern for the markets.

Unspoken is the importance of the market mechanism to ensure that resources are used scientifically (rationally/sensibly). So, without the fanfare of Deng or Zhu, China's march towards a market-based economy continues, it just does not get highlighted – nor does it need to be any longer. Similarly the role of the private sector was not emphasised but its participation even in healthcare reform, where the state will again play a larger role in basic provision, was a welcome reminder of its importance and acceptance.

The other rising priority is democracy, or, as Hu means at this stage, inner party democracy. This may well be the biggest change over the next decade, with Hu setting the agenda for his successors in the Fifth Generation to further the process.

Dismissed by many outside China as a contradiction in terms, it should be taken seriously if for no other reason than Hu mentioned the term for

democracy 60 times in his speech to the 17th Congress. The initial emphasis may be on grass roots elections as a way to introduce some competition into the process so as to improve government performance.

This time senior posts were contested with more candidates than places. This may be extended to 20 or 30% more candidates than places. The hope is that it will remove the corrupt and incompetent without any bloody head-on confrontations.

Some five years ago I asked someone familiar with the Party School, whose remit is to ensure the Communist Party stays in power and to think through all threats to it, including from within, what was the most important research going on into economic policy. "Oh all that has been done in the 90s" was his reply. "Those who want to be on the fast track these days do political reform, as this is seen as the most knotty problem".

Who was the last head of the Party School? Hu Jintao. Which new subject did he introduce for study? Religion.

Who Is Hu Jintao?

"Who is Hu Jintao" will increasingly become the question. Will he remain the grey man frightened of the shadows or is he someone preparing China for all the changes that flow from economic change? Put differently, will the post-Revolutionary generation be grey apparatchiks, as happened in the Soviet Union, or will it change enough to transform the economy, polity and society?

As Lee Kuan Yew reflected in a recent interview, Chinese leaders are thoughtful people (in stark contrast to what he had to say about Burma's). They have thought about what comes next both economically and politically.

The intriguing thing about Hu's past is whether he has an affinity with or was influenced by Hu Yaobang, the one genuine liberal to rise to the top of the Communist Party only to be replaced in the political turmoil of the late 1980s. Hu, no relation of Hu Jintao, headed the Communist Youth League where Hu Jintao was deputy secretary general until deciding it might be safer if he put in for a transfer to the provinces. Today it is the Communist Youth League and its alumni that form Hu Jintao's power base. Is their colour grey or have they been hiding their true colours until they reached the top?

What Next?

One area that receives little attention is religion, again seemingly unthinkable in an officially atheist state. However do not be surprised when the next round of talks over Tibet are held with the Dalai Lama's representatives in the New Year or if relations with the Vatican are normalised. As one

shrewd Taiwanese commentator has noted, how better to welcome the world to the Beijing Olympics than with these spiritual leaders represented...and Taiwan?

Even the recent proposed change in national holidays says something about change. Two of the three days to commemorate May Day have been removed and in their place will be days to mark the Mid-Autumn Festival, Sweeping of Ancestral Graves and Dragon Boat Festival (to remember the suicide of an honest official who drowned rather than continue in a corrupt kingdom). For a culture heavy on symbolism these changes are very much of the times. Another way to look at them is to see three very Chinese holidays cutting back a foreign transplant, May Day.

The process is also very interesting. The government put the proposal on the Internet, inviting comments. People were asked to "vote". Within a day some 390,000 were said to have responded - interesting Beijing had the confidence to invite feedback.

Some say that the government is becoming more populist. Indeed there is no doubt that the unprecedented execution of the head of the Food and Drug Administration was in response to public anger over corrupt officials whose greed and incompetence directly caused deaths. Given what would now be called the democracy deficit, anything to promote accountability (Hu's goal, rather than democracy itself) is likely to be favoured.

Inviting responses though is to involve people to participate in the decisions. For Beijing understands that the greatest threat to long-term stability is if economic prosperity gives people independence from the state and leads to independent thinking of their relationship with it.

The appointment this year of not just one but two ministers who are not Communist Party members shows how expertise is prized more than ideology. Neither the Minister of Health, after SARS and Avian flu plus the decline of the healthcare system a very important position, nor the Minister of Science and Technology, with a background in the foreign auto sector, are party members. They will probably not be the last.

We anticipate more changes in the social and political realms than most in the markets expect. Assuming these are introduced without setting off unintended consequences they will change China and with it reduce further its political risk.

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