Ear to Asia podcast

Title: Minding Xi's business: How commercial enterprises navigate China's political landscape

Description: With the housing sector on the brink, high youth unemployment and slower than desired GDP growth, 2023 is shaping up to be an annus horribilis for China's economy. Since many of its current economic woes are due to the lingering effects of its zero-COVID policy, it should come as no surprise that Western media are portraying this state of affairs as the consequence of overreach by Xi Jinping and the authoritarian Chinese Communist Party. However, the reality of the complex relationship between the CCP, commercial enterprise, and China's economic performance is far more nuanced. Asia political scientist Dr. Pradeep Taneja and China law specialist Associate Professor Colin Hawes join host Ali Moore in examining how the Party's internal dynamics and sometimes arbitrary decision-making both help and hinder China's vast business sector. An Asia Institute podcast. Produced and edited by profactual.com. Music by audionautix.com.

Voiceover:

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Ali Moore:

Hello, I'm Ali Moore. This is Ear to Asia.

Pradeep Taneja:

Most of China's technology companies, they don't have a choice but to work with the party. And if the party shows genuine sort of concern and encourages private sector investment, stops penalising people and harassing private sector investors, then perhaps, you know, there could be some return but I can't see him back to its heyday.

Colin Hawes:

I think that Xi Jinping has to find some way to encourage private investors again because he can't rely on the state-owned enterprises, mainly because those enterprises have drained the economy. Although they built huge amounts of infrastructure – some of it's amazing – but only the private enterprises were able to turn enough of a profit and to produce that engine that drove the economy forward.

Ali Moore:

In this episode, there's no business like Xi's business, how China's firms navigate their country's political landscape.

Ear to Asia is the podcast from Asia Institute, the Asia research specialists at the University of Melbourne.

China's economic performance has been tepid so far in 2023, with high youth unemployment and GDP figures falling well below expectations. Despite the abrupt termination in late 2022 of the government's three-year long zero-COVID policy, that policy had a huge impact not just on the Chinese people, but also on Chinese businesses, and severely disrupted global supply chains.

Western media have been quick to infer that this is the expected outcome of unfettered overreach by an all powerful Xi Jinping and the ruling Chinese Communist Party or CCP. Pre-COVID, Beijing had imposed wide-ranging crackdowns on the technology and media sectors and even the private

tutoring industry, wiping out hundreds of billions of dollars of value from the economy. Yet while the CCP flexes its raw power over the corporate sector, it's had limited success in eradicating corruption, despite undertaking numerous anti-corruption campaigns since Xi Jinping assumed leadership in 2012. So just how omnipotent is the CCP and its leader Xi Jinping in steering industry in China? How do the party's internal politics drive its relations with China's vast commercial sector? And to what extent is the business environment in China harmed or helped under an authoritarian system, too often marked by arbitrary or contradictory decision-making? Joining me to examine the relationship between the CCP and business in China are Asia political scientist, Dr. Pradeep Taneja from the University of Melbourne and China law expert associate professor Colin Hawes from the University of Technology Sydney. Welcome to Ear to Asia. Colin, and welcome back, Pradeep.

Colin Hawes:

Thanks, Ali.

Pradeep Taneja:

Thank you, Ali.

Ali Moore:

Let's start with an overview if you like. Pradeep, how would you characterise the role of the CCP in business in China? Is it the ultimate authority as it is in politics?

Pradeep Taneja:

It certainly is. Chinese economy has been dominated by the party since the People's Republic was founded in 1949. Economic reforms did decentralise authority post 1978, and a lot of the economic decision making was devolved to the provinces and to the local level. But when it comes to overall control over the economy, the CCP definitely dominates the economy. For example, recently, the party has been trying to encourage more private investment, because private investment is not growing very well at all. For example, in the first quarter of this year, private investment grew by 0.6%, whereas state investment, that is fixed capital investment, grew by 10%. And so economic growth still seems to be driven by state-owned sector rather than the private sector. So the CCP has been trying to encourage private companies to invest. But when they talk about encouraging private investment, they keep saying, "We will guide private companies how to invest, and how to invest in quality development."

And that seems to be the whole issue because the party likes to control everything, including obviously the economy. And we did have a period in the 1990s, even in the first decade of the 21st century, when there was a lot of free flowing capitalist style economic development happening in China. But that has come to an end. That party has now, in the last couple of years, they've cracked down on a lot of the tech sector companies, including the private tuition companies – the coaching, educational coaching companies. So overall, that has put a dampener on the private sector and the party is now trying to revive that.

Ali Moore:

But Pradeep, what does guiding mean in practise?

Pradeep Taneja:

Well, this really goes back to the economic planning days. When Chinese economy was largely economically planned, the State Planning Commission, the precursor to the current NDRC, the National Development Reform Commission, used to plan the whole economy. And then in the late 1970s, they began to say, "Okay, let's have two different types of plan." And one plan was what they

used to call in Chinese, [Mandarin], directive style planning where the party essentially dictates what needs to be done. Two, a new form of planning, which they call guidance planning, that we guide the industries including the private sector. So I think we are now back to another party trying to guide the private sector, to guide the whole economy. And I don't think the private investors in China are particularly persuaded by that approach.

Ali Moore:

Colin, how do you see the relationship between the party and business?

Colin Hawes:

I basically agree with Pradeep there in terms of the overall attempts of the party to guide the economy. And that would include trying to introduce policies that encourage private enterprise at certain times and other times trying to restrict it. But at the same time, I think there's this typical pyramid view that we have of the Chinese government and the Communist Party, as if Xi Jinping is at the top and a small number of party leaders control pretty much the whole country. And that's a very rather simplistic view, and that's not what Pradeep said, but many people have that view.

And in fact, what we actually see is at many different levels, there's government officials, party officials, who are influenced by their own self-interests, corruption and personal networks, which are called guanxi in Chinese. And that frequently subverts the attempts of the central government to either guide or control, including controlling the private enterprises. And so it's more like a maelstrom of corporate and political interests competing with each other with many different vested interests. So that makes it very difficult for the Central Party to actually enforce what it wants over the economy and over private enterprise. And when they do try to enforce, they often are too blunt about it and like Pradeep said, it can have the opposite effect of discouraging private enterprise. So when they control too much, it leads to a slackening off and then they have to let go again.

Ali Moore:

We will come back to that and what that means for the country and for the economy. But Colin, just as a bottom line, given those complexities and those layers within the party, if push came to shove, would business have to do the parties bidding?

Colin Hawes:

If you have a central government, Central Party directive, saying that this industry is no longer permitted to exist, as happened more or less with the private tutoring industry recently, then those companies have to find some other business to do. They won't be able to continue in that kind of business. But generally speaking, you don't normally get those kinds of prohibitions coming down. It's more like they give rather vague policy directions and it leaves a lot of leeway for both the corporations and the government officials at different levels who have to implement the policies, to do things in the way that they want to according to their own benefits.

So it depends on the kind of policy that the Central Party is trying to enforce and how committed they are to enforcing it. The other thing is they might have a very strong political type campaign to enforce a certain policy for a short time. But then after a couple of years, it gets forgotten. You can see that with the video game industry where they said, "Oh, we're not going to allow video games to be sold so frequently." But a couple of years later, companies like Tencent seem to be doing very well with their video game industry after having waited out the storm, if you like.

Ali Moore:

Before we get to other examples, Pradeep, can I ask you that of push came to shove question?

Pradeep Taneja:

I think the party's relationship with the private sector particularly is complicated. Private sector is essential for China's economic growth. The private sector employs 80% of China's workers. Private sector contributes 60% of the total output. So private sector is absolutely important for the economy. It's not like the situation 40 years ago. Today, private sector is the key driver of China's economy. And what we are seeing now in terms of, as I mentioned earlier, the private investment in fixed capital is really ground to a halt and state is trying to increase the role of the private sector, but at the same time it wants to control the private sector. So that is the fundamental contradiction as I see. The Chinese Communist Party is saying to the private entrepreneurs in China that, "We respect you, we recognise your contribution. But at the same time we would guide you, we will tell you what to do."

So for example, just this week, the NDRC, the National Development and Reform Commission, has told the media that the local development and reform commission ... Because there is a national level NDRC, and there are local level development and reform commission. And these local level development and reform commissions have together submitted proposals for more than 2,900 proposals, totaling about $445 billion US. These are proposal for investment by the private sector. So they're saying that, "Look, we are inviting you to invest in these sectors. And these sectors include transportation, clean water, clean energy." So I'm sure some of the private entrepreneurs would find these investments attractive, but many others would have their own plans and their own ideas. And therefore, they would be looking for opportunities where they find the opportunities, rather than be guided by the state. And that seems to be the problem as I see it, because there was a time when the party had essentially co-opted the private sector.

Jiang Zemin, when he was the leader of the Chinese Communist Party and president of China, in 2001, his so-called theory of Three Represents was essentially an attempt to co-opt the private sector. In other words, bring the private sector entrepreneurs inside the tent, rather than leaving them outside. Leaving them outside the party system is too risky, too dangerous, and therefore Jiang Zemin tried to bring them inside the tent. What's happened under Xi Jinping over the last 10 years is that the private entrepreneurs no longer feel that they are inside the tent. They feel distinctly that now they're outside the tent. And that seems to be the problem to me.

Ali Moore:

Do you agree with that, Colin, that there was this compact made with private enterprise under Jiang Zemin and that compact has essentially been broken?

Colin Hawes:

Well, I've put a slightly different emphasis on it. I think what Jiang Zemin did was to open up the economy to private enterprises, to say, "You are welcomed to develop private enterprises and to keep the profits and the party will not stop you from doing that. You are one of the three representative groups in society along with the workers." So he brought them in, in that sense, but didn't interfere so much in their development of their businesses. There was a lot of talk about the separation between the government and business and not trying to interfere too much in their businesses. But the problem with that approach, as it developed from about 2005 to 2016 or so, was that many of these private firms expanded extremely quickly like these tech firms, their platform firms like Alibaba and Group. And they started getting into things like finance, providing banking services and other kind of investment opportunities for ordinary people.

They expanded so quickly, but they weren't being actually regulated. They were doing it in grey areas. So for example, Ant Group, which is the financial spinoff from Alibaba, which they do Alipay, the payment services, they also provided these loans and other financial products to ordinary people. And they were working with thousands of financial institutions to do that. And nobody was

very clear about whose liability it would be if those loans went bad or millions of people were left with their life savings lost.

It became quite a chaotic situation, and around 2016, many of those investment firms collapsed the so-called peer-to-peer lenders, leaving tens of millions of ordinary Chinese people without their savings. And there were protests on the street and the party saw that as a very unstable situation. So that's I think the period when Xi Jinping and his fellow leaders started to try and reign in these private enterprises which had expanded so quickly, and they lost a bit of faith in the power of the market to regulate those kind of firms. And so that's when they started this whole approach of trying to guide them more into what they see as positive kind of investments.

Ali Moore:

It's interesting though, Colin, because you clearly see what happened to Jack Ma and the Ant Group as a crackdown on monopolistic practises. Others see it as the sort of perfect example of the power of the party over business. And Jack Ma did effectively challenge the regulators and the banks, didn't he? At one point, he said, "The banks suffered from a pawn shop mentality." Do you think there was any element in the crackdown on Ant Group, of a fear not just of economic instability but political instability, that they were considered a potential rival in the political space?

Colin Hawes:

Well, I don't think the Ant Group or Alibaba, which is a related company, were a political threat in that sense. But it's true that Jack Ma made a speech in front of the vice president of China and some top banking regulators and basically criticised them to their faces, saying that, "You should not be regulating us, the tech firms, with our brilliant financial services industry that we have developed ourselves. We can assess the risks better than you can, basically." In as many words, that's what he was saying. He basically made them lose face there, some of these top party leaders. And so in some ways it's not surprising that they looked into what his company and others were doing and thought, "This is not a very well-regulated situation. We don't really know what the risks are here." He drew attention to himself in a very kind of, you could say, not very cautious way.

So I'm not saying he deserves to have been sidelined in a ... As he almost went out to the public eye for about two years. But there was reason for the government to be worried about this development of this whole new industry, which was not being regulated in the same way that normal banks were being regulated. And since that time, what they have done is to bring Ant Group and other platform finance companies under regular banking regulation systems so that they have more capital, and it's very clear who is lending money to whom, and who the liability will fall on it if things go wrong. But they haven't nationalised those companies and they haven't stopped them being private firms in terms of their shareholdings. So it's not like a complete turning away from the private economy. It's just trying to show that the party cares about regulating those kinds of firms and that they don't want things to go wrong.

Ali Moore:

Pradeep, how you interpret what happened to Jack Ma and Ant Group?

Pradeep Taneja:

I agree with Colin about the Ant Group and particularly the risk of financial chaos and the loss of confidence in the financial system by the public. And as Colin referred to, those protests when a couple of banks were nearly bankrupt, it led to street protests by the people. And the Chinese Communist Party fears nothing more than chaos. So impulse to control the financial system and control companies like Ant Group, is quite legitimately linked to the Party's need to control them. But I think also people like Jack Ma and many other Chinese billionaire entrepreneurs represent a threat

to the system. They're very powerful. People with billions of dollars of capital are not powerless people. And the old compact that I referred to earlier, where the party felt that they could live with these people as long as they were contributing to the ultimate goal of China's economic development, I think under Xi Jinping, the equation has changed.

There is much more emphasis on control than on economic growth. For Xi Jinping, economic growth is not an end goal itself. Economic growth is intended to serve a particular purpose, which is to sustain the party's legitimacy. And anything that comes in the way has to be dealt with and dealt with rather harshly. And that's I think the primary reason why many people like Jack Ma, not just Jack Ma, many other Chinese entrepreneurs are lying low, keeping a very low profile, moving their money out of China if they can. Because they don't feel that the business environment in China and particularly the political environment in China, is conducive to private investment.

Ali Moore:

If we can just go back to the issue of historical context and in particular Pradeep, the crucial step that you say was taken by Jiang Zemin in allowing private entrepreneurs to join the party and to thrive, what were the implications of that for the long held expectation, not held so much now, but certainly held in the West, that the entrepreneurs and the new wealthy would be the forces for democratisation in China?

Pradeep Taneja:

That's a very interesting question, Ali. This has been a view which is influenced by modernization theory, that when in an authoritarian system, when private sector is allowed to grow of necessity ... Obviously, even authoritarian leaders and dictators want the economy to continue to grow. When that happens, when private sector begins to play an important role, and you have the so-called new middle class that emerges as a result where you have people who almost suddenly become wealthy and then having accumulated certain amount of wealth, they want to have a say in sharing essentially political power. They want to have a say in how the country's governed, how laws are made. And that was, I think, the thinking even behind the policies of the Clinton administration. You might remember Bill Clinton, when he was running for president, he called the leaders of China “butchers of Beijing” because of the Tiananmen Square massacre in 1989.

But once he became president, his attitude towards China changed. And essentially, I think he was being informed by people who were telling him that if we continue to engage with China, if China remains open and Chinese companies continue to trade with other countries, China's private entrepreneurs remain free to engage in business and make profit, then eventually we don't have to do anything. China will change itself.

In other words, this so-called new middle class will take care of things because ultimately, it is in their interest that China has a political and legal system where their private wealth would be protected. Something similar to what we have a separation of powers, for example, where judiciary would be independent, where the private wealth would be protected by law. But unfortunately, that hasn't happened. And particularly Xi Jinping, since he came to power in 2012, as the party general secretary later on as president in 2013, he has really changed the thinking within the party, particularly in terms of the attitude towards private entrepreneurs and particularly the more successful and richer entrepreneurs. And that seems to me to be the crux of the problem, because Xi Jinping sees them as a threat. He sees that as a conspiracy of the West, to try and weaken or undermine his government and to undermine CCP rule. And that's why these private entrepreneurs are seen as a danger, as a risk by Xi Jinping.

Ali Moore:

Colin, would you like to respond to that?

Colin Hawes:

Yeah, I think one reason that Xi Jinping and some of the other senior leaders see private entrepreneurs as a threat is because they have become incredibly rich. Compared to back the early 2000s, there were very few billionaires in China. But from about 2010 onwards, you start to get these people who are tens of billions of dollars worth of fortune, incredibly rich people. And so that gives them, as Pradeep said, a lot of influence using their money. Secondly, another reason is that that process of undermining the party or subverting the party was actually happening. And so first of all, there was a huge amount of corruption within the party itself. And corruption basically means that private businesses, whether big or small, are bribing government officials at various levels to allow them to do things which would otherwise not be approved, if they went through the normal channels, whether it's because of bureaucracy or because of regulations, et cetera.

So because of that corruption largely driven by these private businesses, it was undermining the party itself. The party really couldn't control itself very well. And there were situations where, for example, large numbers of the provincial People's Congress representatives were being bought up – those positions by private entrepreneurs themself. They were becoming People's Congress representatives by bribing their way into those positions. And many party officials paid for their own positions and their own promotions. And that's the kind of thing that I think Xi Jinping was worried about. It wasn't just that some private entrepreneurs might be subverting or trying to overthrow him. It was more that the whole system had become almost like a corrupt mafia type organisation. And so the threat really is there. It's not just something that he imagined the party was falling apart and they saw it as an existential crisis, and that's why he started that whole huge anti-corruption campaign.

Ali Moore:

Colin, you write that, "The problem of corruption and fragmentation within the party are so widespread that efforts to assert central control will always be like a dog chasing its tail." Do you see corruption and the anti-corruption drives indeed the platform that Xi Jinping came to power on? Do you see it as a tool to wield, particularly against potential political rivals? Or do you indeed see it as a massive challenge, given the situation that you were just describing about how incredibly embedded corruption is?

Colin Hawes:

I think there's no doubt that Xi Jinping has used the anti-corruption campaign to get rid of some small number of very senior party officials who were trying to either go against him or become his successor when he was not ready to hand over power. So Sun Zhengcai was one of them, and Bo Xilai was obviously ... He was trying to engineer a coup back in 2011, '12 against Xi Jinping.

So this anti-corruption has been used to get rid of some political rivals. But the scale of the anti-corruption campaign is so huge, it cannot just be that. And there's been studies carried out about the types of officials who have been ensnared, and there's no clear factional alliances that can be traced. It is definitely an attempt by the Xi Jinping government to crack down widely on this phenomenon of party officials taking bribes and engaging in this very extravagant lifestyles, instead of serving the people. Just the numbers can tell you. There's been almost three million party officials, have been disciplined in some way, and hundreds of thousands have been put in jail. They can't all be enemies of Xi Jinping trying to take over his position. It's a much wider phenomenon than that. So I see it as a doublethink in a way.

Ali Moore:

And we have to recognise of course, that Xi Jinping is not the first Chinese leader to instate an anti-corruption drive.

Colin Hawes:

No, that's definitely under Hu Jintao. They tried to start anti-corruption campaigns. And even back in the fifties, even under Chairman Mao, they've been doing it in waves if you like. And so that's part of the whole thing I was mentioning earlier, that they have this loosening up stage where they allow business to flourish and less direct attempts to control it. And then that often leads to these kind of corruption phenomenon as business people and politicians work together to benefit themselves, and then they try to crack down. It's just that this time, has been a much larger and longer crack down than before. But my research has found that there are still some very senior party leaders who apparently are corrupt, and that right through the system, people find ways to still benefit themself, even despite this anti-corruption campaign. You see the same types of industries, the same party secretaries of state-owned enterprises or state banks. New generations of them being prosecuted for corruption even when five years ago, the same companies, the same thing happened. They haven't somehow dealt with the systemic problem here.

Ali Moore:

You are listening to Ear to Asia from Asia Institute at the University of Melbourne. And just a reminder to listeners about Asia Institute's online publication on Asia and its society's politics and cultures, it's called the Melbourne Asia Review. It's free to read and its open access at melbourneasiareview.edu.au. You'll find articles by some of our regular Ear to Asia guests and by many others. Plus, you can catch recent episodes of Ear to Asia at the Melbourne Asia Review website, which again you can find at melbourneasiareview.edu.au. I'm Ali Moore and I'm joined by China law expert, Associate Professor Colin Hawes, and China political scientist, Dr. Pradeep Taneja. We're discussing the complex relationship between the Chinese Communist Party and commercial enterprise.

Pradeep, how do you see the role of corruption when it comes to this core question of the party's grip on business?

Pradeep Taneja:

Ali, corruption has been around for a very long time. As Colin earlier said, Hu Jintao, Jiang Zemin, also talked about the risk of corruption, corruption being a serious problem. I think Hu Jintao described corruption as the cancer, which is eating away at the core of the party. And he in fact talked about that this could bring down the party. And there used to be small scale corruption in the pre-1978 era. But the scale of corruption of course increased as market opportunities emerged in China. As China's economy began to change, profit motive emerged and it was easier to become quite wealthy and make your life comfortable by engaging in corruption, by both sides, by officials and the entrepreneurs. But there was an understanding I think in the party, until Xi Jinping's rise to power, that corruption is a fact of life.

We need to try and control it, and at least we need to create a perception among the Chinese people that the party is doing something about it. But corruption in a system like that which lacks transparency, where there's no freedom of the press, corruption is impossible to control. And that's why, as Colin was saying, corruption still exists. There are still officials who are deemed to be corrupt. When you talk to people in China, you hear stories about corruption both at the local level and in Beijing. But there was an understanding before in what I call the Deng Xiaoping era, from 1978 until 2012, even though Deng Xiaoping, of course, died in 1997. But influence of his thinking continued until Xi Jinping's rise to power. And under that regime, corruption was tolerated as essentially the price that you have to pay for the economy to grow rapidly.

I think Xi Jinping has taken a much more ideological view of corruption and he seems to be much more worried about the party losing control than his predecessors were. And that's why we are seeing a combination of this fear, this paranoia about losing control, and this ideological orientation

that is ... Been revived under Xi Jinping. Corruption does exist, as I said. Nobody is denying that there is corruption.

But in the system that China has, corruption was seen as a price to pay. From time to time, you arrest people, you prosecute people, you sentence them to prison, even sentence them to death. But what Xi Jinping has done is really try to control it in such a way that it is seriously impacting the enthusiasm of private entrepreneurs in China. There's an old saying in China, and I'll see if I can translate that correctly in English. It says that, "When you relax things, it leads to chaos. And when you have chaos, you try to control chaos. And essentially what you have is death by control." And I think from the private entrepreneur's point of view in China, this attempt to control corruption is essentially killing the private economy.

Ali Moore:

There is also, of course, as Pradeep just said, this issue of transparency, which brings me to the question of the judicial system. Colin, if I can ask you, that particularly from a business perspective, how fair, how impartial, and perhaps most importantly, how transparent is China's judicial system when it comes to business?

Colin Hawes:

So actually the legal system for commercial interest has improved quite a lot in the last 20 years. And the transparency has also improved with over a hundred million of court judgements being posted online. And they even have videos of trials that you can watch and some other countries that are rule of law countries we normally think of, don't even have that level of transparency. But the problem is there's some distortions in the system. So if you are dealing with typical business contract dispute between two corporations in China or a foreign corporation and a Chinese corporation, in most cases, you will be able to get a pretty fair hearing in a Chinese court and they will just follow the law. And in a similar way as an Australian court might follow their own law. And foreign businessmen who have been involved in disputes in general find that the process there is quite fair and relatively efficient, much quicker than and cheaper than bringing a lawsuit in other countries, rich countries.

But when you have a dispute with either a corporation or you're trying to sue some kind of state-owned enterprise, for example, that has very close links with local government or central government officials or powerful party officials' families, that's when the distortions come in and the influence of the party, and it's not really officially allowed, but because they have the power, they interfere in those kinds of cases and they basically tell the judges, "You should decide in our favour rather than the person who's bringing the lawsuit." So those distortions exist just as they do in the government itself, like the corruption, the self-interest, and the guanxi, the personal networks, in those cases where one party has more power and more influence. It's not the majority of cases, but there are definitely those influences.

Ali Moore:

That guanxi that you talk about, it's a very well-known lubricant for doing business if you like. How would you describe it and is it a euphemism for corruption, or is it a little more subtle than that?

Colin Hawes:

Yeah, it's not the same as corruption necessarily. It's about having good relationships starting with your family. You do anything for your family and they do for you. You benefit each other as you can because of your human sympathy for those people. And then that extends out to friends, friendships that you have developed, whether people from the same place where you grew up or your school or university. Often, those relationships are very strong and you do favours for each other because that's part of your friendship. But when you're running a business, often you will try to develop those

friendship relationships with the people who can help your business, and that often means government officials. A lot of work is done by business people to develop those government relations. It's not like our idea of government relations where you have lobbying and things.

It's more like going out for meals and inviting those officials for dinner, giving them gifts at birthdays or Chinese New Year, et cetera. That's where it starts to go over the line into corruption. And I think what Pradeep was saying about Xi Jinping breaking the compact, if you like, that whole guanxi system between businesses and politicians in China had a whole almost fixed way of doing things. You knew how much you had to pay to get certain types of approval for things and licences and other safety permits, et cetera.

But that's been disrupted by the anti-corruption campaign. And so it's not so clear now what government officials can do in terms of gifts, in terms of going out for dinner with business people. So they don't dare to do those things. And that the whole system grinds to a halt in a way because it's a massive country and it's difficult to get things done if you don't have the help of the local government officials. So guanxi is human relationship as we would typically do it in Australia, but it can go further into a more almost utilitarian and manipulative way of getting government officials on your side when you're running a business.

Ali Moore:

Colin, both you and Pradeep have mentioned state-owned enterprises, which we haven't really looked at. So actually I'll ask you Pradeep. Where do SOEs, or state-owned enterprises, fit into the business landscape? They've been around since the Mao era, haven't they?

Pradeep Taneja:

Well, they certainly have. After the Communist Party came to power, essentially nationalised all the private businesses, they were already some state-owned businesses that existed before the Communist Party came to power. In fact, going back to the Qing Dynasty, one of the major Chinese state-owned companies, the China Merchants Steam Navigation Company, which is a state-owned company, it actually goes back to Qing Dynasty. So there there's been a long tradition of state-owned companies. And they used to play much bigger part in the Chinese economy before the economic reforms began. But since the 1990s, their share in the economy has continued to decline. As I said earlier now, their contribution is only about 40% to the output. It used to be 80% if you exclude agriculture, et cetera. So their share in the economy has come down. But they still play a very important part because many sectors of the Chinese economy, including things like energy, oil and gas, transportation, civil aviation, are still largely dominated by state-owned companies.

And these are the so-called commanding heights of the economy. The Chinese Communist Party is very reluctant to let go of those areas. And that's why it's interesting that in this decision this week by the National Development Reform Commission, this guidance which has been issued to encourage private investment, they're saying that they're opening sectors like transportation. The sectors like clean energy, water, are being opened to the private sector. So because of the economic impact of the decline of the private sector in China, the party is now willing to open some of the sectors which were otherwise exclusively reserved for the state-owned enterprises. Now, they're willing to open at least some of them to private investment.

Ali Moore:

And indeed, Colin, you argue if I'm correct, that just because they're a state-owned enterprise in name does not mean that they are completely prepared to do the bidding of the party.

Colin Hawes:

Yeah, that's right. And so because they are run now on a commercial basis, they're supposed to make money and the more money that they can make, the more the people running those state enterprises can basically siphon off for themselves and their employees. And that's what most businesses want to do. So what that means is that many state enterprises, for example in the power industry, the coal-fired power station, that a lot of those are built by state-owned power firms. They tend to expand as much as they can and build as much as they can, and they make use of state bank loans because they can get access to that money. But they don't necessarily think about whether those projects are going to benefit China or to reduce pollution, for example. They tend to think in terms of their own, "We are this state-owned enterprise", which is a little fiefdom.

"We have to benefit ourselves by growing, by giving ourselves these opportunities to give favours to private enterprises, give contracts to those people. And in return, for bribes for ourself." So that you have these state-owned fiefdoms that expand as much as they can. And in the coal-fired power sector, that's led to a situation, that kind of ludicrous, where these power stations are only being utilised to 50% of their capacity, because there's just hundreds or thousands of these power stations have been built and they weren't even necessary. And in many cases, they were illegally constructed and the central regulators turned a blind eye because they themselves were paid off. So you could see that being a state-owned enterprise doesn't necessarily mean that you are acting for the benefit of China or the party as such. It's like you are officially owned by the state, but you have quite a bit of autonomy to make those decisions, especially if you work with the local governments who also want to benefit in a similar way.

Ali Moore:

Talking about acting for the benefit of the party, if we're talking about the party and its influence on business, Pradeep, it would be very hard to not mention Huawei, which we haven't to date. China's top communications manufacturer, of course, it's become central to disagreements with a number of countries. The US, Australia, Japan, and a number of others have effectively banned Huawei from building their 5G networks. What are the issues around Huawei and how valid are they?

Pradeep Taneja:

Huawei is an interesting case study because Huawei claims that it's a private company. But the way the Chinese government defends Huawei in countries, for example, where restrictions have been imposed on Huawei, as you mentioned. For example, refusal to allow Huawei to participate in building 5G network or in Australia in the national broadband network, the Chinese government very strongly defends Huawei. So Huawei, it's not a public company, it's not a listed company, and therefore there is very little transparency as to the ownership structure of Huawei. Huawei was founded by a man called Ren Zhengfei. Ren Zhengfei has a background in the People's Liberation Army in the Chinese military, and he believed to have initially at least succeeded in building this company because of his connections with the military and the government, and essentially by working as a reseller of computer equipment and IT equipment to Chinese government and the military.

So because of the opaque nature of Huawei, there has always been a suspicion about Huawei, that Huawei acts essentially on behalf of the Chinese government. Many foreign governments have tried to deal with it. In Britain for example, the British government had set up a lab in London where the agreement was that all Huawei equipment would be tested to make sure there was no back doors in those equipment, and before the equipment could be installed in the communications network in the UK. And Huawei agreed with that and they said this could be a model for other countries to follow. But now even the British government has changed its approach to Huawei. So Huawei, while it's doing very well in many developing countries, in most of the developed world, Huawei faces a very stiff business environment where its brand has become synonymous with Chinese state interference.

Ali Moore:

But is that, Pradeep, for example, the decision that was made by the UK, was it based on any fact or is it based on potential, as opposed to reality?

Pradeep Taneja:

It's very difficult to say for me whether there was any evidence because governments haven't really produced any evidence publicly. But the intelligence agencies in many of the developed countries, in the Western countries, they seem to be suggesting to their governments that they should not allow Huawei. And it's partly I think because of this fear that Huawei is essentially a cover for Chinese military and Chinese security agencies, and therefore, it cannot be trusted.

Ali Moore:

And there have been allegations and charges of course around intellectual property theft in the US.

Pradeep Taneja:

There have been cases very. Very early on, Huawei paid a huge compensation and basically settled out of court in a dispute with Cisco. Cisco Systems, an American company, which also makes communications equipment. There was a case filed by Cisco and they accused Huawei of copying their equipment so much so that they had even copied the manual from Cisco. And ultimately, apparently, I think if I remember from memory, Huawei paid more than $200 million US to settle it out of court.

Ali Moore:

Colin, do you think that the concerns around particularly the threat to national security, the risk of espionage that is behind this banning by a number of countries including Australia, do you think that they're valid concerns?

Colin Hawes:

Well, I have a slightly different take on Huawei, having looked at it for many years and looked into its ownership structure and background. And I just want to go back to the UK situation. The reason that the UK decided not to allow Huawei to continue building its 5G networks was largely because of pressure from the United States because the United States basically sanctioned Huawei and said that we're not going to allow some of your key components to be supplied like semiconductors and things like that. And that meant that the UK government could no longer ensure that Huawei would be able to continue supplying. And it was very clear that that's why they pulled out of allowing Huawei to continue building their networks. But in fact, the person who was advising the UK government at that time was Ciaran Martin, who was the head of the UK's National Cybersecurity Centre at GCHQ.

And he objected to that and he said that was a wrong decision because he said that, "If Huawei was a supplier of part of the UK's 5G network, it could well be controlled by the UK government. The risk could be controlled." And he felt that it was only because of that pressure that prevented the UK from going ahead with that. And in terms of Huawei's so-called military connections, a lot of that evidence was massaged and quite distorted by US government inquiries, especially a congressional inquiry that was held back in 2012. But when you look at the sources that they showed to try and prove the connections of Huawei with the Chinese military, those sources did not actually make that connection clear. When you look at Huawei's business, it's very clear that it's been a private employee-owned firm ever since the beginning. And its success came from supplying its equipment, its networks, initially telecom switches, and then internet networks hardware, to the state telecom firms in China, which are like China Telecom, China Mobile, et cetera.

And it actually did this by sharing its profits with those through joint ventures, with those telecom firms and their officials and employees. So it benefited those employees and officials personally, and that's why they were so keen to use Huawei as their supplier. So it goes back to this idea of the self-interest of some of these state-owned enterprises, and that allowed Huawei to expand extremely rapidly in the late nineties to the early 2000s. And then they expanded overseas and were able to supply their equipment to many developing countries. And from that, because of their success, they were able to invest in research and development and become one of the innovators. So their early years, maybe they had some IP issues where they were sued. But later on, they've now become an innovator and they have tens of thousands of patents, not just in China, but in the United States as well for their own inventions, especially in the 5G area.

And that's why governments, if they could use Huawei, they would want to because they have the latest technology in that field and they are much cheaper than the competitors. So in terms of the actual risk though, the problem is there's always going to be a risk that the Chinese government is going to try to infiltrate networks of whatever kind, whether it's the hardware or using hacking to get into networks that are not even produced by Huawei, and they seem to be quite successful at doing that. And so the problem is not so much with which supplier you have, as Ciaran Martin put it, in the UK, it's more whether the governments in those other countries are able to protect their networks no matter which suppliers they have. And they haven't done a very good job of that so far. And to say Huawei would be the problem I think is a bit misleading, because the problem is that we haven't learned how to protect any network, whoever produces it.

Ali Moore:

At the same time, Colin, if Huawei is just another company, how do you account for the fact that the Chinese government detained two Canadian citizens, once Canada had detained Huawei's CFO, who happens to be the daughter of the founder of Huawei. If it was just another company, they have allowed that process to follow out legally? And indeed in the end, as I understand it, those charges against Huawei's CFO were dropped.

Colin Hawes:

So that was a really interesting case. And I think maybe the first question is why was she detained in the first place when the evidence against her was so weak?

Ali Moore:

Sure, but governments don't intervene in those cases. It was an immediate retaliation where the Canadians were arrested.

Colin Hawes:

Yeah, so I agree that Australian government and probably the US government would not normally detain as a retaliation, would not normally detain some random Chinese citizens to try and put pressure. And I think that's part of what I was saying earlier about the party sometimes does interfere in the legal system in China, and they probably thought, "Oh, if we do this, we might be able to put pressure on the US government basically." But it backfired on them and they really shouldn't have done that. It was a very bad decision definitely. At the same time, in the United States, there have been quite a few Chinese scientists and academics who have been arrested on very thin evidence and later found to have been pretty much unsubstantiated charges. And so it's not the same thing, but there's an element of arbitrariness that seems to come in when you get into these political disputes.

As for why they did it for Huawei, when the Huawei chief financial officer was arrested in Canada, then the question is why would the Chinese government get involved? I think you have to think in

terms of what would the United States government do if Apple's chief financial officer was arrested, their world, their global chief financial officer was arrested in China, would the United States government step back and allow that to go ahead, or would they put a lot of pressure in many different ways on the Chinese government to release them, even though Apple is a private company? We have to try and look at it from that point of view. But at the same time, to recognise that the Chinese government really made a stupid mistake by arresting two people who had nothing to do with this whole dispute. They were two completely innocent Canadians. That was a terrible error.

Ali Moore:

Pradeep, do you agree? An error?

Pradeep Taneja:

I wouldn't call it an error. I think it was a very deliberate decision to try in engaging some ransom behaviour because Huawei is too important to the Chinese state. And not just in this case, but the general tendency to protect Huawei and to defend Huawei, across the world, leads me to believe that there is something more than just an ordinary private company owned by the employees. I'm not sure, for example, with the ownership structure, and perhaps Colin can help clarify. If it is an employee-owned company, when an employee leaves Huawei, do they actually take out their share?

Colin Hawes:

So when they leave the company, they have to sell their shares because they are only for employees and then they get paid out according to a formula which calculates the market value of those shares. And that's clearly written into the agreements that all these shareholders have with the company when they first get their shares. But I agree that the Chinese government thinks Huawei is incredibly important, and that's for two reasons. One is Huawei has a 50% market share of China's own 5G networks, and the Chinese government relies very heavily on Huawei and one other company called ZTE and other Chinese private company has 30%. So 80% of the 5G network in China is basically maintained and produced by these two companies. And the problem is if Huawei is unable to continue because of all these sanctions and because its executives are getting arrested and things like that, that will mean the Chinese government will lose its own Chinese supplied networks and they'll have to rely on foreign networks. And that's obviously a national security concern for them.

And also overseas, Huawei has helped in terms of developing good relationships with many developing countries because it's basically constructed those similar types of internet and telecom networks, with the help of finance provided often by state Chinese banks, so that those countries don't have to pay upfront for their more advanced telephone and internet networks. And many of those countries are quite poor. So it's good for China's diplomatic efforts getting support at the United Nations and so on, to have Huawei almost like improving China's reputation overseas. So that's why they are important to the Chinese government.

Ali Moore:

I think we could actually do an entire podcast on Huawei, and perhaps we should. We are almost out of time, but I did just want to finish with a question to each of you about the future. And Pradeep, you talked about how steps are being taken to reinvigorate private investment. But if Xi Jinping has broken this compact, how does he get it back? Does he have to get it back? And what happens if he doesn't?

Pradeep Taneja:

That's a good question, Ali, because it is true that the party has been trying since at least early this year to come up with new packages of incentives for the Chinese private sector. There was a

guidance issued in April by the party, and now of course this week, we've had the National Development and Reform Commission issue guidelines for the private companies to increase their investment. Offering them, as I said, more than 2,900 projects where private companies would be welcome to invest. But I think there was that level of trust between the private entrepreneurs in China and the party, which seems to have been broken. And I think reestablishing the trust is going to be quite a challenge. It doesn't mean that it can't be done, but it would mean reversal of many policies and the party and Xi Jinping. The Chinese Communist Party leadership in general will have to show that they truly welcome the private sector and show it not just by some statements, which Xi Jinping has already done, but also through their actions.

There are many Chinese companies which have no other way because these companies, biggest market is China. Most of China's technology companies, all these technology platform companies, their biggest market share is in China. They have very little share overseas. So in many cases, they don't have a choice but to work with the party. And if the party shows a genuine concern and genuinely encourages private sector investment, stops penalising people and harassing private sector investors, then perhaps there could be some return. But I can't see, going back to its heyday, when private sector was booming in China and private sector investors were generally very happy with the overall business environment.

Ali Moore:

And is that because the point that you made much earlier in this podcast, that this is ideological for Xi Jinping?

Pradeep Taneja:

Exactly, because Xi Jinping has really brought ideology back to the centre of Chinese politics, and his orientation is very ideological. And I can't see that changing, I think ideology will continue to be at the centre of Xi Jinping's politics.

Ali Moore:

Colin, how do you see the future and the future of private investment?

Colin Hawes:

Well, I think that Xi Jinping has to find some way to encourage private investors, again, because it can't rely on the state-owned enterprises, mainly because those enterprises have drained the economy. Although they've built huge amounts of infrastructure, some of it's amazing, like the high speed railways and the transport highways, et cetera, but a lot of it is useless and wasting money and getting the country into this massive debt crisis, especially at the local government levels. And the state-owned enterprise can't turn enough of a profit to counter weigh the debts that they're piling up. And only the private enterprises were able to do that and to produce that engine that drove the economy forward. And so he's got to find some way to do it to avoid a massive financial crisis. And he can't just rely on ideology because government officials in China are paid very low compared to people in the private sector.

Maybe just one third of the salary of a typical tech worker would be the government official's salary. And so the government officials have to rely on the so-called grey income that they get from the private entrepreneurs, et cetera. So Xi Jinping's idea that they're going to be honest and hardworking, serving the people, it's just not going to work with people who have regular type of self-interest, which those officials would have, and they've demonstrated that in the past. So he's got to relax basically. He's got to be more relaxed about the private sector if he wants to save the Chinese economy.

Pradeep Taneja:

And apart from the economy, Ali, there is another factor. Youth unemployment in China has become a huge problem. Unemployment amongst youth between the age of 16 and 24 is currently at about 21%. And Communist Party really puts a very high premium on social stability. And social stability would be challenged very seriously if youth unemployment is not brought under control. And for that, the private sector is much more important than the stated-owned sector.

Ali Moore:

Maybe it's a case of needing to save the economy and save the party as well. An enormous thank you to both of you for being so very generous with your insights and with your time. Thank you, Colin, and thank you, Pradeep.

Colin Hawes:

Thanks, Ali.

Pradeep Taneja:

Thank you, Ali.

Ali Moore:

Our guests were Dr. Pradeep Taneja from the University of Melbourne and Associate Professor Colin Hawes from the University of Technology Sydney. Ear to Asia is brought to you by Asia Institute at the University of Melbourne, Australia. You can find more information about this and all our other episodes at the Asia Institute website. Be sure to keep up with every episode of Ear to Asia by following us on the Apple Podcasts app, Spotify, or wherever you get your podcasts. Please rate and review us. That helps new listeners find the show. And put a good word in for us on your socials. This episode was recorded on the 25th of July 2023. Producers were Kelvin Param and Eric van Bemmel of profactual.com. Ear to Asia is licenced under Creative Commons Copyright 2023, the University of Melbourne. I'm Ali Moore. Thanks for your company.