

## ***Xiconomics: Mixing Politics with Economics after the 19<sup>th</sup> Party Congress***

Elizabeth Freund Larus  
Professor of Political Science and International Affairs  
University of Mary Washington  
President, E Larus Consulting

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This paper examines Xi Jinping's economic reforms (commonly known as *Xiconomics*), in which Chinese businesses must submit to Party-state control. It seeks to determine the measures that Chinese businesses, industry, media and social networks need to take consistent with Party-state control. Specifically, the paper seeks to answer the following questions: Will *Xiconomics* stifle innovation of state firms and private businesses? Will indigenous innovation will discourage FDI inflows? Is *Xiconomics* sustainable as a viable economic policy? The paper finds that *Xiconomics* is not about market-oriented reform, but about reform to the things that the Party-state can control: big data and artificial intelligence, the internet and modern supply chains, green industries and modern infrastructure.

### **Introduction: Xiconomics explained**

“Xi Jinping Thought on Socialist Economy with Chinese Characteristics for a New Era (“*Xiconomics*” for short), is Xi Jinping's effort in his second term as party chief (2017-2022) to mix politics with economics. Specifically, Xi seeks to strike a balance between reform and political stability.<sup>1</sup>

Xi's main political and economic goal is stable, medium-level growth (at least 6 percent) and Party-state control over key sectors of China's economy. Xi and Premier Li Keqiang set an annual growth target of about 6.5 per cent for 2018. In the past decade, high growth rates of 6.9 percent or more were achieved at the expense of heavy borrowing, which was necessary to drive government investment in real estate and infrastructure. China's highly leveraged economy means that government at all levels in China carry heavy debt. But Xi will not cut China's debt drastically for fear that it will cause massive instability. Rather, Xi will seek to promote **high-quality growth**. This entails expansion of **high-tech and high-end manufacturing and services that have benefitted from China's impressive achievements in information and communications technology (ICT), AI, cloud computing, big data and other cutting-edge sectors**. At the same time, Xi seeks to

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<sup>1</sup> Willy Lam, “What is “*Xiconomics*”? *China Brief*, January 12, 2018, 4.

**curtail zombie firms**,<sup>2</sup> reduce inventory, and promote efficiency of SOEs. **Supply-side structural reforms** (SSSR) emphasize more spending on education and social welfare, reducing poverty, and protecting the environment. It also includes big data and artificial intelligence, the internet and modern supply chains, green industries and modern infrastructure.<sup>3</sup>

What is remarkable is Xi's leadership in economic policy making. This is the first time since the establishment of the CCP almost 100 years ago that the party chief is the highest-level designer and arbitrator of economic matters.<sup>4</sup> (Mao focused more on political and military issues; finance matters were left to expert planners such as Chen Yun and Li Xiannian, and Premier Zhou Enlai. Deng Xiaoping was not party chief during the era of Reform and Opening. He left the mechanics of reforms to others, such as Hu Yaobang and Zhu Rongji.)

### **Significance of Xiconomics for Chinese and US businesses**

For Chinese businesses, The **United Front Work Department** works to shape private-sector behavior. It provides incentives, technical support, and networking opportunities for Chinese entrepreneurs. UF organizations are key to how Chinese industries network, receive resources, and speed through regulatory processes. It is impossible to grow a supply chain or larger corporation without connections to United Front organizations.

For **US businesses**, it means being shut out of China's supply chain no matter how good the *guanxi*. In a recent poll, 75 percent of respondents felt that foreign companies are increasingly unwelcome there, with regulation remaining a major concern. AmCham's most recent member survey reported that 81 percent of respondents felt foreign businesses are less welcome in China than before. Likewise, less than three-quarters of U.S. China Business Council member companies have an optimistic five-year outlook, the lowest total over the past decade.<sup>5</sup> Oversight over foreign enterprises is unlikely to lighten as China pursues "indigenous innovation" in the lucrative sectors identified in its **Made in China 2025** plans. Forced technology transfers or unethical data theft by individual staff members poached by Chinese firms pose real risks to multinational businesses, as does the growing presence of the Chinese security state.

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<sup>2</sup> Zombies are companies that earn just enough money to continue operating and service debt but are unable to pay off their debt. In short, they cannot stand on their own feet.

<sup>3</sup> Barry Naughton, "Economic Policy in the Aftermath of the 19<sup>th</sup> Party Congress," *China Leadership Monitor* No. 55, January 23, 2018. <https://www.hoover.org/sites/default/files/research/docs/clm55-bn-final.pdf>

<sup>4</sup> Lam, 4.

<sup>5</sup> "Doing Business in China"

<https://uk.practicallaw.thomsonreuters.com/8-501->

[1377?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/8-501-1377?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1)

**Security** has become the standard justification for the array of new laws and regulation enforcements targeting multinational firms. Many of the private-sector activities being controlled don't fall under traditional concepts of national security, but for regulators, "security concerns" can describe problems ranging from how a website classifies Taiwan to the degree of market access a technology firm possesses. Foreign businesses are increasingly at risk from political events and controversial security developments. For instance, China boycotted South Korean co. Lotte after the company acquiesced to the US putting a missile system on Lotte-owned land. As a result, Lotte withdrew from the China market last year.

To carry out his agenda, Xi is rewarding loyalty with key positions in government. For instance, Xi promoted loyalist Liu He to vice premier. Liu now leads trade negotiations with the United States, and he also helped formally integrate "Xi Jinping thought" into China's economic plans. As Xi's consolidation of power continues, China's domestic policy world is signaling that Made in China 2025 is about what Xi wants, with little wriggle room for any deviation.<sup>6</sup>

So far, China's private businesses are complying with China's broadening security view. Many of China's private sector companies, and even industry leaders, are building their business model predominantly around the needs of the state. In turn, it is likely that China's trade and industrial policies, from data rules to technology transfers, will be built to benefit the domestic firms that it intends to boost. Xi's message to China's firms is clear: Cooperate, and your organization can prosper. Operate outside of the government's standards, and you'll find operations more difficult. There's no escaping the new political agenda in the Chinese market.

### **Xiconomics' Impact on State and Social Media**

**State media** have quickly expanded their overseas operations, while the government has pushed patriotic videos on western social media platforms. As of the last two years, Beijing has structured initiatives to encourage patriots who share positive messages about China, such as the Communist Party youth league's "Volunteer Campaign to Civilize the Internet." The youth league functions to strongly encourage the **web patriots** to always navigate online discourse in a patriotic direction. The "**little pinks**" aka the **web patriots/nationalist trolls** are now the most vocal members of a social media community inhibited by government censorship. Their war cry is "If you don't repost this, you're not really Chinese" and this cry often works in pushing toward Xi's long-term outcome.

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<sup>6</sup> Rui Zhong, "'Smiles Won't Get CEOs Far in China,'" *Foreign Policy*, July 25, 2018.  
<https://foreignpolicy.com/2018/07/25/smiles-wont-get-ceos-far-in-china/>

A school, called **Bai se** (Executive Leadership) Cadre Academy, has created a training program for prospective ASEAN trainees with the purpose to influence officials from ASEAN countries by helping them understand China's economic development and governance model." Officials are coached on "guiding public opinion" online. Topics covered include the operations of CCP committees and the opening up and reform of China. Trainees are also trained in how to alleviate poverty in a "targeted" way through the use of their words via the Internet.

In March 2018, China **consolidated all state-run media** under "**Voice of China**" under the management of CCP's Central Propaganda Department, which controls film, radio, television, book publishing, Internet and the news media. Under "Voice of China," all Chinese media networks are expected to post articles that spread the positive image of China as well as positive image of the Xi Jinping Thought. South China Morning Post, Xinhua, online media all have comments that were clearly written by 'nationalist trolls' in support of an article written by the Chinese state-run media that would sometimes present an opposing view but always placed a positive twist on what was said.

**Social Networks.** To promote Xi Thought abroad, the rise of Chinese nationalism has created a volunteer army of Chinese "patriots" who promotes China, champion "socialism with Chinese characteristics," and rebut criticism of Chinese politics. In the past, these "patriots" were also known as "50 cents" as they were paid for each post, but now they are enthused to carry out their duties and serve their homeland for free. China's economic might, coupled with perceptions of Western decline, have blown up the propaganda to carry more weight at a global scale. "Tell the China story well and build China's soft power," President Xi Jinping encouraged delegates at the 19<sup>th</sup> Party Congress. The **nationalist trolls**, mainly men, are attempting to spread a positive image of China through any form of social networking that they can.

Xi Thought seeks to seep itself into the minds of all Chinese and help change the minds of foreigners to acquire foreign investment and widespread support for the Chinese model that he is pushing to become a dominant leading force on the global stage. Outside of foreign investment, Xi Jinping is trying to change the global perspective of China so that the global stage will come to respect and accept China as a leading force/replacement to the U.S. (even though he's being careful with his wording).

Despite the CCP's encouragement to "spread positive messages" about Chinese society, the CCP will help the little pinks/patriots by providing memes created by state agencies and private studios to attack/ coordinate "mass bombings" of public figures' social media platforms, attacking them with intimidating posts and eliminating online debate.

The nationalist trolls also coordinate and organize via private Facebook groups. One group has 40,000 members that all must prove that they are Chinese before joining. Targets have included international airlines mistreating Chinese customers, Lady Gaga's Instagram

account after she met the Dalai Lama, and Taiwan's pro-independence president. Victims also included Taiwanese President Tsai Ing-Wen as she continues to refuse to claim one-China policy. All attacks are meticulously planned and trolls share tips on how to access Facebook, Twitter and other foreign sites normally blocked by The Great Firewall of China.

### **Effect of Xiconomics on Innovation**

While the tech sector is known for its relentless innovation, that innovation requires flexibility. Full Party-state control stifles innovation. If the CCP puts certain incentives in place, however, major state-firms should be able to contribute greatly to China's economic growth. In fact, some scholars note that *political stability fosters innovation*; political uncertainty would bring about a decrease in innovation.

Arguably, the only way that Beijing can achieve its goals for economic growth and development is for the Chinese government to give tech companies the space they need to maintain – and get ahead of – competition. With Xi Jinping Thought, Beijing has created a system in which Chinese firms have a vested interest in the CCP's future.

Currently, Beijing's level of influence on a company varies from firm to firm. While many of the most effective and capable technology companies have been able to exploit the "variable interest entity" (VIE) structure<sup>7</sup> (the so-called Sina model) and secure the funds needed to get ahead, most SOE's did not initially establish themselves on the Chinese market before going overseas. (Ex: Baidu Inc, Alibaba, Sina Corp, Tencent Holdings Ltd., and Huawei Technologies Co. Ltd).

Although President Xi cited innovative achievements by Chinese corporations at the 19<sup>th</sup> Party Congress, innovation and political control are not compatible with one another, as entrepreneurs dislike party intervention. For example, the reason why companies such as Huawei have been successful and why 8,000 start-ups are being born every year is that they are located far from Beijing in the southern end of Guangdong, once dubbed an "independent kingdom."

Steel, automobile, cement, and electric appliance industries no longer lead China's economic growth. Instead, promoting innovation is the way that the economy can gain rapid strides again. The CCP can pose a challenge to such growth due to aforementioned concerns that an innovative entrepreneur can easily gain control and possibly sway public

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<sup>7</sup> A variable interest entity (VIE) refers to a legal business structure in which an investor has a controlling interest in, despite not having a majority of voting rights; or a structure involving equity investors that do not have sufficient resources to support the ongoing operating needs of the business. Beijing places many restrictions on foreign investors seeking to invest in Chinese SOEs. Certain imaginative individuals created the VIE system, which circumvents certain legal restrictions in China, to attract foreign venture capital or private equity financing in the early stages and completing offshore listings.

opinion if left entirely unchecked. For that reason, China keeps a strong hold on certain incentives while trying not to keep too tight a grip on innovation so that it can grow. That said, Internet restrictions are even stricter following the 19<sup>th</sup> Party Congress and restricting the flow of capital and information will not result in a strong inflow of creativity.

Party-state control can stifle innovation and likely will, as the CCP does not want to be perceived as controlled by its businesses. Very critical to remember is that Xi Jinping Thought is about keeping Xi as the “core.” President Xi and the CCP will not allow anything less than a full hold of what is going on within China. Beijing’s definition of “entrepreneurship” states that it involves **patriotism and professionalism followed by observed discipline, obeying laws, innovation and serving society.**

The CCP has made it clear that it expects to control business decisions for state firms, private companies, and joint ventures with foreign partners. While years back, Beijing had worked toward promising economic liberalization, the CCP has decided to pursue greater control over civil and economic society. The CCP has set up party cells in SOEs, taking back control of the sizeable segments of the economy that developed outside its influence in the almost 40 years since Deng Xiaoping eliminated classic Marxist recipes such as price controls and state ownership. The party **cells being set up in SOE’s explicitly include the role of the party in management decisions, including the establishment of party-controlled unions in foreign multinationals’ Chinese operations.**

While foreign investors know that their Chinese state firm partner answers to the CCP, the addition of **Party cells within the joint ventures makes relations much more difficult than usual by adding another layer of authority to day-to-day operations.**

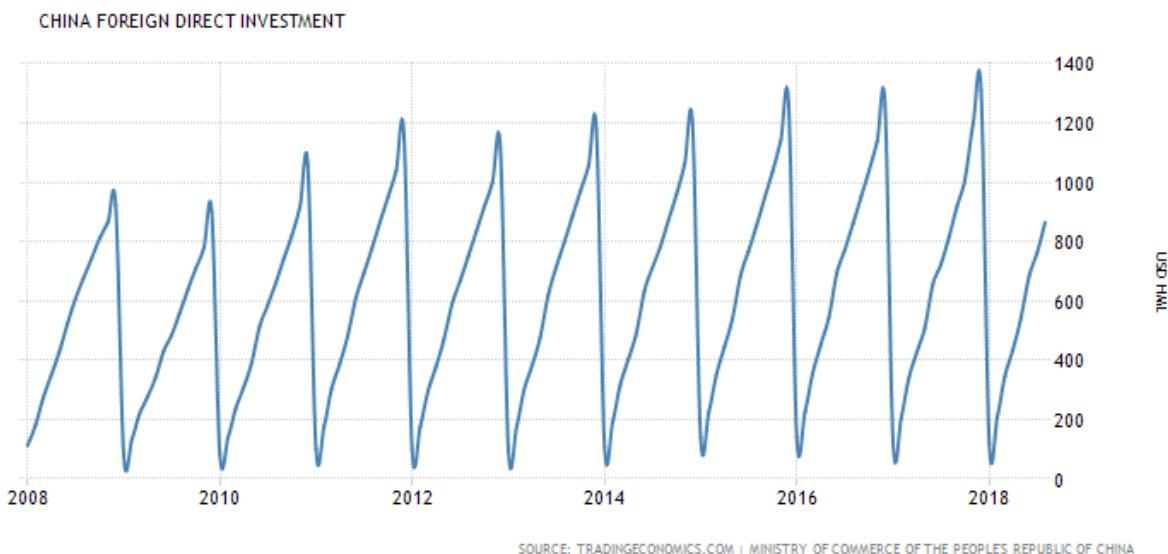
### **Effect of Xiconomics on FDI**

There is not much evidence to support the argument that China’s Indigenous Innovation will discourage FDI inflows. In 2006, the CCP began to pursue an indigenous innovation policy that would meet certain technology goals by 2020 and 2050. This policy would lead to the Chinese dominance of tech markets that are usually the domain of companies from South Korea, Japan, and the United States. The 19<sup>th</sup> Party Congress has made it clear that indigenous innovation will continue to be a priority for the CCP. Xi claims that **technology** is an important **instrument of the state** and has called for “self-reliance,” indicating that China intends to continue to forge ahead in the tech sector. This means that Party-state will continue to influence indigenous innovation companies.

There is a popular argument that FDI inflows would stall because of “promise fatigue” after government promises to further open up the Chinese economy have come up empty. Despite the concerns of II, FDI inflows continue to increase albeit it a slower rate. In the first quarter of 2018, FDI inflows FDI rose by only 0.5 percent. (FDI actually fell when adjusted for inflation.) China is still the world’s second largest FDI recipient after the US.

Its attractiveness as a destination for investment capital rests on its development of infrastructure, resource availability (physical and labor), productivity and workforce skills, and the development of the business value chain. The level of maturation of these elements can make China more attractive for FDI relative to other nations, such as India, that compete and vie for the same investment capital. <sup>8</sup>

**Figure 1.**



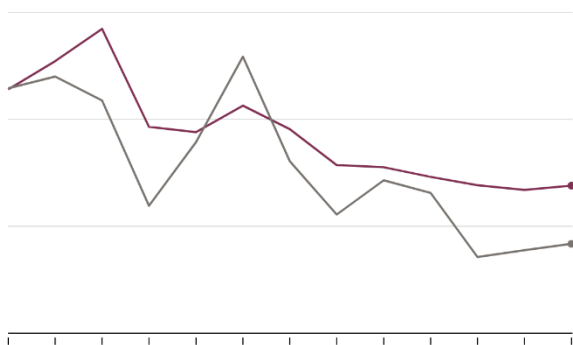
### Viability of Xiconomics as an Economic Policy

The 19<sup>th</sup> Party Congress approved Xi Jinping Thought as an economic policy with Xi as its “core.” Xiconomics is more of a political agenda than an economic plan. Historically, the Party Gen-Sec looked after politics, and the Premier looked after economics. After the 18<sup>th</sup> Party Congress, China watchers dubbed Li Keqiang’s economic management “Liconomics.” Liconomics” referred to Chinese Premier Li Keqiang’s economic ideas: no stimulus, reducing debt and structural reform. However, these ideas soon disappeared the responsibility of the Premier, Xi wrested management of the economy from Premier Li Keqiang at the 19<sup>th</sup> Party Congress. This indicates that the politics of economic reform are more important than the economics of economic reform. Other than continuing to strive for more than 6% economic growth, Xiconomics seeks to do so under firm Party control. This differs from the **Jiang Zemin** no-holds barred approach to the economy, and **Hu Jintao**’s attempt to continue rapid economic growth with lip service to social harmony.

<sup>8</sup> Marvin Dumont, “Top 6 Factors That Drive Investment In China,” Investopedia, August 7, 2018. <https://www.investopedia.com/articles/economics/09/factors-drive-investment-in-china.asp>

Jiang's policies helped fuel China's rapid economic growth, with GDP averaging 10 a year. Xi is taking back the reigns. Xiconomics gets away from the past model that focused solely on raising GDP and stimulating economic growth, and to gradually get the nation's economic growth rate to stabilize at a slower pace of about 6.5 percent. It emphasizes adjusting China's economic structure and strengthening the role of market mechanisms. We have seen a level of comfort among the Party leadership for lower GDP growth, and attempts to transition from a labor-intensive and capital-intensive economic growth and development to technology intensive. We have not seen advances in the role of the market in the economy under Xiconomics.

Figure 2



The figure at left begins in 2005 and shows annual GDP growth or contraction through 2017. China's official rate is above 6%. The CEIC rate is below 5%.

Source: "China's Economic Growth Looks Strong, Maybe Too Strong."  
<https://www.nytimes.com/2018/01/18/business/china-gdp-economy-growth.html>

China's economic is still highly leveraged. Xiconomics or not, the CCP will have a difficult time deleveraging the economy. Lower level cadres are afraid to report negative numbers up. Hence the smooth trajectory above as compared with the [NY-based] Conference Board (CEIC).

Another threat to the economic viability of Xiconomics is the US-China trade war is a threat to Xiconomics. Since early July 2018, the Trump Administration has imposed tariffs on \$250 billion worth of Chinese imports. Nearly half of all Chinese imports into the United States now face levies. Trump claimed that he was prepared to tax all imports unless China decreases its trade surplus with the US and removes pressure on US firms to share their IP with Chinese companies. Weakening foreign demand and sluggish domestic consumption are causing Chinese manufacturers to scale back production. Privately owned makers of cars, machinery and other products stopped expanding in September 2018, as export orders dropped the most in more than two years. Output at large SOE manufacturers likewise continued to weaken.<sup>9</sup> Such a slow-down will likely prompt Xi to stimulate the economy by loosening credit and government spending. This move might encourage businesses to borrow more, pushing China's already high debt levels even higher.

<sup>9</sup> "Trade Fight Hits China's Economy," *Wall Street Journal*, October 1, 2018, A6.



China's leaders appear to believe that the trade war is part of an American plot to maintain economic hegemony and to keep China down. Now that Xi and the CCP system have decided that America's real goal in the trade war is to "thwart China's rise" the CCP is starting to rollout official reactions, with self-reliance as a key theme. Xi had already expressed this in his Made in China 2025 and Indigenous Innovation policies. Trump's actions did not instigate this self-reliance movement but may accentuate it. For instance, during a late September tour of China's northeastern provinces, Xi underlined the importance of self-reliance in food security, the real economy and manufacturing as China faces a trade war with the US. He claimed China's path of self-reliance is not a bad thing as it forces China to rely on itself as it is becoming increasingly difficult to gain access to leading technologies and key technologies internationally.<sup>10</sup>

## **Conclusion**

Xiconomics focuses Party-state efforts on transitioning China's economy from a labor-intensive export-oriented path to development to a high-tech economy that is partly engineered by self-reliance. Its emphasis is on technological innovation, AI and big data. At the same time, China's leaders seek advances in education and social welfare, reducing poverty, and protecting the environment. These efforts likewise will be guided more by the Party-state than the market. If the West is looking for signs for market-oriented reform, it will have to wait a bit longer.

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<sup>10</sup> "Xi stresses nation's self-reliance," *China Daily*, September 27, 2018. <http://www.ecns.cn/news/politics/2018-09-27>