

**Interview with Dr. Victor Shih, Associate Professor of Political Science at the UC San Diego
Keck Center for International and Strategic Studies
February 24th, 2015**

On February 24th, the Keck Center for International and Strategic Studies interviewed Dr. Victor Shih, Associate Professor of Political Science at the UC San Diego. Professor Shih, an expert in Chinese political economy, was also the first analyst to identify the risk of massive local government debt in China. In his interview with Aman Ghose CMC'15 and Henrietta Toivanen CMC'17, Shih discussed the state of the Chinese economy, the consolidation of power at the center, as well as a broad range of foreign policy issues.

The state of the Chinese economy is a major question, especially given the way the BRICS nations and other emerging economies in general are grappling with various economic maladies. The bottom line, for Shih, is that China is going to face some form of an economic crisis, not necessarily a political one. He looks to Russia today as evidence of authoritarian regimes being capable of being resilient in the face of economic calamity. With the ruble dropping 50% over the period of 12 months and, GDP projected to be anywhere between negative 3% to negative 5%, Putin's government has been resilient in maintain political stability. The point Shih emphasizes is that "not every dictator that goes through economic hardship falls from power, therefore its unclear to me why some dictators survive and others don't". To further his point Shih recognized that while Putin's political is far from set in stone, history illustrates the dichotomy of results as Indonesia's regime collapsed as Malaysia and Thailand's did not as a consequence of the Asian financial crisis. Ultimately, Shih is confident that while economic instability in will lead to social instability in China and but predicts that the leadership is well equipped to deal with the consequences of a financial crisis. The CCP, after all, has a "extensive repressive capacity" in terms of physical force, police, and censorship. Given this apparatus it will take a very big shock, and such a shock, Shih predicts will most likely emerge from an internal split. Short of that however, "the party will remain pretty resilient".

When asked about the 25% dip in land usage over 2013-2014, as well as the decline in property prices that has further amplified the debt burden on local government and poses a serious

concern to China's economic stability, Shih asserts that the problem is twofold. Firstly, local governments have developed property without a corresponding demand in the market. China's property market is sustained or 'kept alive', according to Shih, by a handful of mega cities like Beijing and Shanghai. Of the 250 cities with populations of over a million China, Shih states that only 50 are experiencing population growth with the other 200 populations in stagnation or in decline. Secondly, the problem lies in the fact that the property market constitutes a quarter of the China's GDP and as a result the continuing slump in the Chinese property market is an immense drag on the economy, which is growing at its slowest pace in a quarter of a century.

The question is, how well positioned is the Chinese government in dealing with these economic woes and what are its most significant challenges? Ultimately, as was done in the United States, Japan, Europe and so on, Shih claims that China can "print a ton of money and undertake quantitative easing", however goes on to caveat by explaining that quantitative easing devalues the currency and as a result hinders China's ability to be loosely pegged to the dollar. Shih explains that for a long time China artificially kept its currency down in order to maintain its favorable trade advantage, a practice the US heavily criticizes. However more recently in the last three years, China has pumped up the value of its currency in order to accomplish what's known as the internationalization of the renminbi. The Party's logic, Shish explains, is that "if the renminbi is a rising currency people will want to buy renminbi denominated securities, buy it as a reserve currency, conducted trade in renminbi and so on and so forth".

The result of this reversal of keeping the currency artificially low to then transitioning to a strategy of pumping up its value has led to China's real effective exchange rate increasing by 30% in the past couple of years. An increase in such a significant level reflects a substantial appreciation which one school of economists claim is artificially and unsustainably high. Recognizing this, Shih claims that China has taken the safe but prudent approach of letting market forces partially determine the value of the currency, which has since brought the currency's value down vis-à-vis the dollar. The immediate goal of the CCP however is to prevent the spiral of capital flight which is known to depreciate a currency, which further amplifies capital flight, which as a result further depreciates the currency creating a spiral such as in Russia or Argentina for example. To prevent

capital flight the Party Shih believes the leadership will stick to a short to medium term strategy of keeping the currency's value artificially high.

Some of Dr. Shih's research has described the internal dynamics of Chinese elite politics, including his 2009 book *Factions and Finance in China: Elite Conflict and Inflation*. According to Dr. Shih, the personalities of the people on the inside could be divided into roughly two categories: the princelings and the non-princelings. Dr. Shih describes the latter group as reliable problem-solvers and technocrats who are good at compliance, rising through the ranks through appeasing their superiors. Princelings, on the other hand, rely on their well-formed social network. Coming from influential families, they have grown up in the same neighborhoods, gone through the same schools, and developed strong connections in the process. Some of them become businesspeople in the United States or China, some go into the military, and some into the government. "You get drawn into these networks to obtain advancements", Dr. Shih explains. There is an attitude of entitlement among the princelings: "You can be bolder and advocate new policies, you can even fight factional battles with your rivals." He provided the example of Bo Xilai, who carried out a lot of reform programs when he was a party secretary – the current national model for social housing is based on his ideas. "That's something that a non-princeling official would not have dared to do," Dr. Shih points out.

The topic of factional politics is one of Professor Shih's main areas of expertise. He sees the recent purges of senior officials such as Zhou Yongkang (a former Politburo Standing Committee member) and Bo Xilai (a former party chief) as a possible campaign of President Xi to consolidate power. Historically, members of the Politburo have well defined sovereign policy spaces, which while consulting and collaborating with the body in its entirety is largely left under the portfolio of each individual member. Under Xi however, Shih claims Xi chairs all but one or two of the top decision making bodies including the Central Military Commission.

In relation to the new wave of optimism in the Indian economy, Dr. Shih sees a lot of positive aspects in comparison to China. The political system in India outshines that of China, despite its challenges. Policies are carried out with the large constituency in mind, whereas the popular input is lacking. In China, Dr. Shih says, the policies are decided by experts who have

distorted incentives to say yes to the leadership: “It becomes an echoing chamber, where all the experts know what the leadership wants to hear and they say that, affirming the leadership’s opinion.” In popular democracies, catastrophic policies are prevented because there is not this kind of feedback loop.

Dr. Shih also provided his insights into the possibility of achieving a binding climate deal, and how the politics in China will change the calculation. According to him, the Chinese government has incentives to abide by some of their promises. Xi Jinping has made serious efforts to clean out the air in Beijing, not the least because the leadership is also suffering from the extreme levels of pollution in the city. However, one approach to this problem has been to reallocate factories to outside provinces, which will not decrease the aggregate amount of pollution. Another incentive to promote climate efforts is that green technology is seen as another possible growth engine. “They are looking around very hard for what’s going to propel growth in China in the next stage”, Dr. Shih says, “and clean technology is considered one such thing.” A lot of moneys is being invested, albeit in unsustainable ways, to promoting clean technologies and renewable energy. However, Dr. Shih sees a possible change in this approach in the future: “That kind of behavior will come to an end soon, because once you have a massive devaluation, it’s difficult to keep printing money to prop up everything.”

In terms of the overall Chinese foreign policy strategy, Dr. Shih sees China as willing to get more involved. “A part of the reason could be that their military has not fought any serious engagements since the war in Vietnam,” he says. Possible future scenarios could include a conflict in North Korea, with a possibility of Chinese troops being involved. Especially if China doesn’t experience a financial crisis, the likelihood of more military engagement is higher. Another main reasons have to do with the Chinese economy. China is commercially very engaged in Africa, and activities in South America are increasing as well – the country has provided financial assistance to several countries, including Venezuela and Argentina. Dr. Shih sees China aiming for a larger global role: “Xi Jinping wants to make China into a premier regional power, a global power.” Ultimately, however, the country’s global role is going to depend on their financial resources. China has impressive foreign exchange reserves, but in the past months, they have shrank by more than 200

billion dollars. Furthermore, the question of liquidity is crucial: “China is already invested in loans to Russia and mines in Africa. That’s not something you can liquidate for cash when there is a crisis. A foreign exchange reserve has to be highly liquid, otherwise it will not count. If there is a big financial crisis and capital is flowing out of China, how long can China maintain this façade of itself as the premier rising power?”