

The Hu–Wen New Deal

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I

Hu Jintao has significantly shaped China's politics in the recent three years. Along with his political partner Premier Wen Jiabao, Hu unfolds a set of policies that bears his own political trademark. Hu and Wen dismissed incompetent senior officials during the severe acute respiratory syndrome (SARS) epidemic, projected an image of caring for commoners, and polished the leadership image at home and abroad. Hu–Wen new policy initiatives have even earned a positive term, i.e., the Hu–Wen New Deal (胡温新政).

What Hu has achieved politically has come as a big surprise to many overseas observers.¹ Before and even soon after the Sixteen

¹ For a critical analysis of succession at the Sixteenth Party Congress, see Joseph Fewsmith, "The Sixteenth National Party Congress: The Succession That Didn't Happen," *The China Quarterly*, No. 173 (March 2003): 1–16. Richard D. Ewing argued that Hu had a poorly-defined political view. See "Hu Jintao: The Making of a Chinese General Secretary," *ibid.*, pp. 17–34. David Bachman suggested that Jiang was likely to continue to hold on to power. See, "New Leaders, New Foreign Policymaking Procedures?" in *China after Jiang*, eds. Gang Lin and Xiaobo Hu (Washington, D.C.: Woodrow Wilson Center Press, 2003), pp. 115–36.

Party Congress in late 2002, many Western analysts were mystified by Hu's political enigma and lamented his tendency to toe the line set by his predecessor Jiang Zemin and his lack of political followings. Hence the familiar headlines of "Who's Hu?", "Who/Hu's in charge?", and "Is Hu going to be lame-duck leader?".² They had predicted that Hu would have a feeble tenure, would be much constrained by Jiang's followers at the Politburo and the ministries, and could even be reduced to a Jiang's puppet at best, if not replaced by Jiang's favorite choice of successor Zeng Qinghong.

Many of these predictions have turned out to be not true. Even when Jiang still served as the Chairman of the Central Military Commission (CMC), Hu was able to introduce his own policy agenda and fought the SARS decisively during April–June 2003. Contrary to accusations about his obsession with power, Jiang handed the CMC Chairmanship over to Hu in September 2004. This marks the first real smooth power transfer in the People's Republic of China. Succession prior to Hu has been fraught with purges. Three of Mao's hand-picked successors, namely, Liu Shaoqi, Lin Biao and Hua Guofeng, fell from grace. Two of Deng's favorite heirs apparent, namely, Hu Yaobang and Zhao Ziyang, were also purged due to their disagreements with Deng over political reform. Jiang, who was Deng's third and reluctant choice, was nearly replaced in early 1992 and managed to succeed Deng only after he vowed to follow Deng's marketization course.

Hu's surprisingly rapid power consolidation can be explained by the following three key reasons — ongoing institutionalization of China's leadership succession,³ factional balance among the political elites and Hu's effective skills to smooth leadership transfer and establish his authority.

² See Reuters, 15 November 2002; *Times* (Asia), 25 November 2002; *International Herald Tribune*, 21 November 2002; *The Sunday Times* (Singapore), 17 November 2002.

³ For an earlier discussion on institutionalization of leadership succession, refer to John Wong and Zheng Yongnian, eds. *China's Post-Jiang Leadership Succession*, Singapore: World Scientific, 2002. For a brief and recent discussion, refer to LAI Hongyi. 2004. "Institutionalization of China's Power Transfer behind Dramatic Reports," *Hsin Pao* (*Hong Kong Economic Journal*), October 11, p. 23.

Institutionalization of China's leadership succession started in Deng's later years, especially after the 1989 Tiananmen movement. Before 1989, Deng, along with chief conservative Chen Yun, had been pushing for leadership renewal by retiring of veteran leaders and promoting younger technocratic leaders. New selective criteria were set for young leaders — high education, young in age, professional training, and political reliability.⁴ Meanwhile, Deng also favored young leaders embracing his market liberalism, with coastal working experience, and having served in both local and national posts.⁵ However, leadership transition was incomplete, as a few top veteran leaders such as Deng and Chen continued to determine policies and even sack or pick young leaders from behind.

These trends of institutionalization of retirement and promotion were accelerated under Jiang. The age and two-term limits have also been rigidly imposed on top posts (including State President, Premier, and General Party Secretary) in the late 1990s. In 1997, Qiao Shi, the powerful No. 2 of the CCP, retired as he reached 70. In 2002, Jiang also retired from State Presidency and Party General Secretary after he had served in both posts for two terms (another secondary reason was that he well exceeded 70 in age).⁶

Another crucial component in the institutionalization of leadership succession which has been ignored by many China observers is the designation and two-step installation of the core leader. Deng indeed helped institute this arrangement after the 1989 Tiananmen Movement. First, he suggested that each generation of leadership should have a core leader and that he was the core leader of the second generation and Jiang Zemin the third generation.

⁴ For a study of promotion of young cadres in the 1980s, refer to Melanie Manion, 1993, *Retirement of Revolutionaries in China*. Princeton: Princeton University Press.

⁵ For a study on Deng's promotion of young leaders, refer to Hongyi H. LAI, *Reform and the Non-State Economy in China: The Political Economy of Liberalization Strategies*, Palgrave MacMillan, forthcoming, Chapter 4 ("Installing Technocratic Young Leaders").

⁶ For discussion on quasi-institutional "rules" for succession, refer to Frederick Teiwes, "The Politics of Succession," in Wong and Zheng, *China's Post-Jiang Leadership Succession*, pp. 21–58.

Second, he helped the politically fragile Jiang to become the core of the post-Deng leadership by persuading Premier Li Peng and Vice Premier Yao Yilin to accept Jiang's leadership. Third, he proposed that the core leader should control three posts at the same time and become the first among the equal. However, he also suggested that the new core leader could assume the post of the Chairmanship of the Central Military Commission (CMC) sometime after he took over the State Presidency and the General Party Secretary. Deng himself handed over this post to Jiang in November 1989, about several months after Jiang became the General Secretary.⁷

Obviously, Jiang followed Deng's arrangement of phrased succession. He handed over to Hu the posts of State Presidency and the General Party Secretary first at the Sixteenth Party Congress in November 2002. Less than two years later, he passed the CMC Chairmanship to Hu.

The second factor is balance of factions among top leadership. Among the members of the 16th Central Committee of the Party, at least the following groups of factions can be identified — the Shanghai Gang (formerly Jiang's associates from Shanghai), *tuanpai* (associates of Hu's Communist Youth League), economic technocrats groomed by Zhu Rongji and further developed by Wen Jiabao and Wu Yi, and the princelings.⁸ As Cheng Li suggests in his chapter in this volume, there is a balance of power among leaders of the state, the NPC, the State Council, the Chinese People's Political Consultative Conference, and the military between the Shanghai Gang (or the elitist faction) on the one hand and the

⁷ For detailed discussion on China's leadership succession and Hu's power consolidation, refer to LAI Hongyi. 2005. *Hu-Wen quan toushi: Hu-Wen shizheng neimu quan jiedu ji Zhongguo weilai zhanwang* (Hu-Wen under full scrutiny: a comprehensive inside story of governance under Hu and Wen and prospects for future China). Hong Kong: Wenhua yishu chubanshe, pp. 16–41, 64–66, 319–64.

⁸ Clear-cut labels are convenient in theoretical discussion, but hazardous in empirical analyses and forecasts. There are some overlaps among these factions. Li Yuanchao, Jiangsu Provincial Party Secretary and a prominent *tuanpai* member, was also a princeling. Wang Qishan, Beijing Mayor and an economic technocrat promoted by Zhu and then by Wen, was also a princeling.

populist faction on the other. While Li regards the *tuanpai* as the only pillar of the populist coalition, Wen-headed economic technocrats can also be viewed as the other echelon of this pro-populism coalition.⁹ Jiang's associates can thus influence but cannot dictate major policies. This gives Hu and Wen considerable room to introduce their own policies.

Lastly, Hu displays great skills in political maneuvering. Hu skillfully managed his relations with Jiang and earned Jiang's trust and cooperation in leadership succession. In addition, Hu carefully and adroitly finds alliance at the Standing Committee of the Politburo. Hu forged a partnership with Wen upon coming into power and especially in the anti-SARS campaign.¹⁰ During the anti-corruption campaign Hu also worked closely with Wu Guangzheng, his acquaintance at Qinghua University. Later, as Jiang stepped down, Hu has also built a coalition with Zeng Qinghong. Hu also has a relatively smooth relation with low-keyed Wu Bangguo, the No. 2 Chinese leader, or the head of the NPC. In addition, as Cheng Li argues in his chapter, Hu seized opportunities amidst calamities and moved to assert his authority. For example, Hu decisively led an open and intense fight against the SARS during mid April and June 2003 and as a result saw his popularity soar and his authority installed.¹¹ The above three factors combine to explain why Hu could quickly emerge as the new core leader amidst much naysay on his political fortune among China observers.

To be sure, when China enters the Hu Jintao era, numerous new challenges await the leadership. Jiang Zemin has left behind a fast-growing, prosperous economy along with a slowly transforming Communist Party, one that is ideologically flexible enough to embrace capitalists. Jiang has thus built a creditable legacy for the

⁹ We choose to avoid equating the *tuanpai* with the populist coalition and the Shanghai Gang with the elitist coalition. For example, the western development program, a regional policy that helped out the underdeveloped west, was initiated chiefly by Jiang Zemin himself.

¹⁰ Refer to You Ji's chapter for a discussion on Hu's relations with Jiang and Wen.

¹¹ For a detailed analysis of how Hu and Wen established their authority, refer to Lai, *Hu Wen Quan Toushi*.

“Jiang Era” and ultimately, Hu Jintao, too, will have to leave a legacy for himself.

The task before Hu is admittedly not an easy one. For the Communist Party of China, he will have to step up its renewal and internal reform program, while at the same time, strengthen its governing capacity. Will the Party eventually decline and decay in the long run? What can he do to prevent this?

The Chinese economy, having chalked up breakneck rates of growth for 25 years, is beginning to experience many structural shortcomings — its current over-heating is just one of these manifestations. In any case, the pattern of economic growth has to be changed or modified in order to address such burning issues as rising income inequality, widening regional economic disparity, open urban unemployment, and rural poverty. Furthermore, Hu has to tackle huge macroeconomic problems without significantly slowing down the momentum of economic growth, which remains the key to the Party’s legitimacy and the country’s political and social stability.

Similarly on the domestic political front, there are many issues and problems that are crying out for attention. *Pari passu* with rapid economic and social development is the call for better and more efficient governance, less corruption, and greater transparency for many public affairs. Hu has started off by projecting a “pro-people” image. He will be under increasing pressure to deliver more effective public policies that will affect the daily economic and social life of the common people.

Externally, Hu’s diplomatic priority is to minimize frictions with China’s neighboring countries and at the same time to gain greater international acceptance, in line with his “peaceful rise” principle.

Although only mid-way into their first tenure, Hu and Wen have established their distinctive style of governance. On the political front, they have established their popularity, consolidated their power, overhauled the government and the Party institutions for better governance, and promoted rule of law. At home, Hu and Wen project a pro-people image and have introduced many measures to improve the welfare of low strata and disadvantaged social groups and to support the development of underdeveloped regions.

They have also renewed reforms of social welfare, healthcare and demographic policies, and introduced rural and land policy reforms to defuse peasants and re-settlers protests. The Hu–Wen leadership also continues with China’s high economic growth through upgrading technology, improving energy efficiency, deepening financial reform, improving land use policies, and furthering SOE reform. On the diplomatic front, they have maintained stable and operating relations with major powers especially the United States and developed cordial relations with most of China’s neighbors. They have also proposed peaceful rise and peaceful development and actively participated in regional integration and cooperation schemes. In short, the Hu–Wen leadership has breathed new air into China’s politics, economy, governance, and diplomacy.

Nearly three years after the Sixteenth Party Congress and midway into the first Hu–Wen administration, it is high time for us to reflect on how Hu has addressed the above challenges. The East Asian Institute (EAI) sponsored a conference in Singapore in the second half of 2005. Knowledgeable China scholars from different disciplines and from Singapore, the United States, Australia, South Korea, mainland China, Hong Kong and Taiwan discussed and assessed Chinese political, economic, social and external policies in the recent years, especially between 2002 and 2005 that were introduced by the Hu–Wen leadership. This volume is the product of this international academic collaboration. The following section presents the theme of the remaining chapters of the book contributed by these scholars. It identifies common threads in the discussion on the challenges, achievements and shortcomings of the Hu–Wen New Deal and sums up their main findings.

II

CONSOLIDATING POWER AND IMPROVING GOVERNANCE

First of all, as a new leader Hu had to consolidate his power, control the military and assert his authority within the Chinese Communist Party (CCP) and over the country. Drawing on his inside knowledge

on politics in Beijing You Ji sheds light on Hu's strategy of succeeding Jiang and consolidating his power within the military. He suggests that Hu has skillfully managed his relations with Jiang and Jiang's associates at the Politburo Standing Committee (PSC) and used his political popularity to control the military.

According to You, the most risk-fraught problem in China's leadership succession has been a two-lined leadership, where the outgoing and incoming top leaders coexist, resulting in potential clashes of personalities and visions. Hu successfully bypassed this problem by gradually phrasing out the two-lined leadership. First, Hu won Jiang's trust and support by persuading him to remain the Chairman of the Central Military Commission (CMC) and continuing to promote Jiang's "three-represents" theory after the Sixteenth Party Congress. Then Hu gradually took over key posts from Jiang and ran daily external, Party, and state affairs. Hu has also found a crucial ally, namely, Premier Wen Jiabao. Hu and Wen work well together in implementing crucial policies, including SARS and macro-economic management, as well as anti-corruption.

Having built his legitimacy among the populace and the Party through commanding the anti-SARS campaign, Hu starts to consolidate his power within the military. Jiang also turned out to be a friend rather than an opponent in this course. During his short stay after the Sixteenth Party Congress Jiang strove to complete the difficult tasks of military modernization and dismissal of many generals and senior officials. Jiang finally passed the CMC Chairmanship to Hu in September 2004, as agreed upon by the Party prior to the Sixteenth Party Congress. Hu thus takes charge of crucial military appointments, yet continues to embrace military modernization and emphasize civilian control of the gun.

Meanwhile, Li Cheng implies, Hu manages to install his followers into key posts and share power and enjoy truce with rival faction. This enables him to pursue policies that he favors.

Li Cheng identifies two contrasting factions in the Politburo, namely, the elitist versus the populist coalition. The elitist and princelings coalition is headed by the Shanghai Gang that was groomed by Jiang Zemin. This coalition emphasizes economic

efficiency, coastal and the GDP-centered development, and interests of entrepreneurs. On the other hand, the populist coalition coalesces around the *tuanpai*, or the Communist Youth League faction led by Hu. The populist coalition is concerned about social cohesion, balanced regional development, and environmentally friendly and sustainable growth. It endorses a people-centered rhetoric (以人为本) and pays greater attention to the low class and commoners.

On the basis of considerable research, Li demonstrates with great clarity that after the 16th Party Congress, both factions have been at a par at the Politburo and have shared power among the top offices of the state. Yet the Hu–Wen populist coalition seems to earn a greater support among the people and legislators. Hu–Wen introduced a set of populist policies to help out disadvantaged groups and to earn popular support. This is a deliberate act to gain influence to counter the elitist coalition. Hu has also groomed an echelon of *tuanpai* officials as future leaders.

Li's conceptualization offers great insights into policy orientation and interaction of China's leadership. Some leaders, nevertheless, may have murky and mixed characteristics. Thus, it is difficult to assign them to either faction; so it is to equate the *tuanpai* with the populist faction and the Shanghai Gang with elitist faction.

Once Hu consolidated his power, his next political task is to carry out policies and governing the nation in their own fashion. Joseph Fewsmith provides an overall view of Hu's approach to governance. He argues that Hu has chosen a three-pronged approach. The first prong is the illiberal or disciplinarian state which is essentially an authoritarian approach. The Hu–Wen leadership increases the role of security forces and uses laws as a Party's tool to enforce control over internet posting and religious activities, as well as petitions and demonstrations by citizens. Hu also encourages a conservative ideological campaign to denounce neo-liberalism, i.e., "market fundamentalism" and the Washington Consensus, as well as public intellectuals, namely, liberal-minded intellectuals. The second prong is the ameliorative state. Chinese new leadership recognizes the need to help out of those left behind in a booming economy. The third prong is to address the issues of governance within the

Party and between the Party and the citizenry. The local government has adopted more responsive mechanism of governance, as exemplified in democratic consultation in Wenling City and the active Chamber of Commerce in Wenzhou City, Zhejiang Province. These three-pronged policies serve one common goal — maintain the rule of the CCP.

According to Fewsmith, China's leaders have realized that three tasks have to be undertaken to avoid the fiasco of the Soviet Communist Party. First, the CCP needs to renew its ideology (hence Hu's populist stance). Second, in line with the ameliorative approach the leadership wants to address largely-economic concerns of the populace. Third, the leadership wants to improve the internal organization of the Party such as cadre promotion and relations between the Party and the people. However, there remains a tension between preempting liberal trends of thought and liberalizing measures needed for grass-root governance. Fewsmith's framework helps us to make sense a mosaic of political and economic issues in the Hu-Wen New Deal that are discussed in the book.

In line with Fewsmith's proposal that the CCP tries to update its ideology, Zheng Yongnian and Lye Liang Fook examine the Party's efforts in the past decades to reform the Department of Propaganda (DOP) and the media- and ideology-related institutions. The DOP is the foremost Party organization responsible for portraying the Party in the best possible light so as to maintain the Party's legitimacy. Under Hu Jintao's leadership, the DOP has projected the image of a Party that understands the concerns of the common people and that is keen to fight for their interests. Hu announced three new people's i.e. power to be used by the people, concern to be showered on the people and benefits to be enjoyed by the people. The state media was instructed to report daily lives of the people as well as stories of top leaders caring for the common people. The DOP also launched an educational campaign to bolster the Party's image in early 2005, urged cadres to emulate role-modeled cadres by dedicating themselves to serving the people.

Zheng and Lye argue that the Party's DOP still confronts its set of challenges. A pro-people Party image may backfire if the Party fails to deliver what it promises. The DOP also faces societal demands

for a more liberal society for timely and accurate information. Furthermore, an increasing number of mass media players in China will not only complicate the DOP's tasks in serving the Party, but also place the DOP under closer public scrutiny.

For decades, the Chinese state has suffered from low efficiency, rampant corruption, and ineffectual institutions. For example, between 1997 and 2002, 846,000 Party members and 98 provincial or ministerial level officials were disciplined due to corruption, up by 26% from the previous five years. Hsu Szu-chien takes a detailed and empirical look at China's endeavors to overhaul the Party and state organization and to improve governance.

The Hu-Wen leadership have moved gingerly forward in three major areas. First, the Party has reformed cadre recruitment by spelling out proper and more open institutional procedures for promoting cadres. It allows participation by lower-level cadres, permits limited competition, and favors collective decision by leaders. Second, reform is introduced to constrain local leaders' power. Major measures include regularizing the Party representatives' congress, promulgating administrative approval law to enhance administrative legalization, and disclosing information within the Party. Third, supervision of cadres has been stepped up to enforce their responsibilities. A set of Party supervision regulations has been formulated, the role and the independence of the Party Disciplinary Commission has been enhanced, governmental auditing agency has assumed a greater role, media has been employed to supervise officials, and resignations of incompetent officials are increasingly mandated.

Hsu suggests that these reforms have only introduced limited rule by law, accountability, participation and competition. These reforms do move the Party-state in a progressive direction. However, Hu's reforms, Hsu notes, are severely restricted by the monopoly of the Party's political power and their effectiveness is thus curtailed.

Compared with his predecessor, Hu has made much louder calls for respecting the constitution and law. Zou Keyuan examines the efforts by new leadership to promote the rule of law. First, the state promulgated "Implementing the Program of Comprehensively

Pushing forward Administration in Accordance with Law” in 2004 (“the Program” thereafter), declaring its goal to build a rule-of-law government around 2014. As a result, law-based administration is being promoted. Law of administrative licensing has been put into effect, the number of items that require administrative approval has been cut by half, official resignations due to flawed performance have been institutionalized and greater transparency in administration has been mandated.

Second, the Party has attempted to establish a preventive system to curb rampant corruption and has taken several major measures. In 2005 a number of prominent officials were arrested for implication in corruption, auditing of officials has been stepped up, revenue collection is separated from expenditure and officials are shuffled in various posts. Finally, as the public resorts to administrative litigation to challenge governmental decisions and seek compensation, judicial remedies limit the power of the government.

Zou argues that the transformation of China’s government from a management- to a service-oriented not only serves requirements of China’s WTO entry and for developing a market economy, but also is driven by the pro-people policy of the new leadership. The main question is whether the Party and the governmental officials will fully comply with laws. Zou argues that China’s current legal reform can be best characterized as “the rule of the Party by law”. The development towards rule of law, however, is irreversible.

SUSTAINING ECONOMIC GROWTH AND REFORMS

A primary economic task for the Hu–Wen leadership is to sustain high economic growth that China has enjoyed for most of the past two decades. Given that the state has placed much of its claim to legitimacy on providing for jobs and decent income for the populace, this task has profound political implications.

China’s pattern of economic growth in the past decades, according to Wu Yanrui, has its strengths as well as weaknesses. First, China’s growth concentrated in cities and the coast. China’s growth approach has been also “extensive” and based on massive inputs of

capital and labor; it has also depended heavily on trade and foreign investment.

A new pattern of growth, Wu suggests, is emerging in China. First, China is deepening its economic reforms by promoting the dynamic private sector. The government is withdrawing itself from direct involvement in business activities. China has joined the World Trade Organization (WTO) and signed free trade agreements (FTAs) with other countries. Second, China is experiencing structural transformation where the secondary and tertiary sectors are expanding. However, China will have to address its low level of urbanization. Third, China is making technological progress by increasing share of hi-tech in output of products and exports and by improving energy efficiency. Fourth, China is promoting balanced development. China has stepped up the development of its western region and north-east, has reduced or abolished taxes in the farming sector, and has subsidized farming. Fifth, China has made strides in global economic integration. Wu concludes on an optimistic note that further economic reforms, dramatic structural changes, and a transition from an “extensive model” to an “intensive model” will result in the second wave of high growth for China.

One of the weakest components of China’s economy is its financial system, as reflected in long-noticed non-performing loans (NPL). Howard Davies, drawing on his experience on advising China Banking and Securities Regulatory Commissions, provides an overview of China’s financial markets and outlines the reform tasks ahead. China’s financial assets, according to Davies, have been growing twice as fast as the world average. China’s financial system has four special features — a small number of banks, dominance by corporate lending, few bank products for retail customers who make most of the deposit, and low profits of Chinese banks. NPL, poor records of the equity markets, and small private bonds markets weaken the financial system.

Davies argues that several reforms of China’s financial markets are needed. The first is reform of the banking system. In addition to addressing the issue of NPL capital injections and setting up asset management companies, China needs to significantly change the

management, culture and reporting practice of the banks. The second is reform of capital markets. The state's predominant holdings of share of SOEs need to be reduced and Chinese companies need stronger corporate governance. Reforms of the bond market are also needed. The third area is regulatory reform. The Chinese have made strides by establishing three separate regulatory commissions for banking, securities and insurance and by consulting international advisory councils. However, the three Commissions need to collaborate more closely and address regulatory inconsistencies. China needs to upgrade staff skills, recruit able staff, and foster a climate in which their staff can challenge the institutions in their charge. Davies concludes that Chinese financial system has changed dramatically in recent years and that the prospects of its future are bright.

Another daunting economic task for China is to reform SOEs, where strengthening of their corporate governance is the key. Sarah Tong examines and assesses the SOE reform. She starts with a review of SOEs reform in the 1980s and the 1990s. The reform significantly cut the total number of state-owned and state-holding industrial enterprises down to 30,000. In April 2003, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) was formed to regulate SOEs and to represent government investment. This body also directly controls nearly 200 industrial firms called Centrally Administrated Enterprises (CAEs) which are the largest and most important SOEs.

Since its establishment in 2003, the SASAC has pushed for a number of initiatives to restructure SOEs. It formulates rules to facilitate SOE restructuring and prevent asset stripping in the process. It tries to sell out the non-circulating state shares. In addition, the SASAC aims to enhance its role as representatives of enterprises' owners. To push CAEs to become modern corporations and to encourage external investment, a significant portion of high-quality assets has entered the domestic and overseas capital markets.

Even with these initiatives, SOEs and state-assets have yet to be efficiently and effectively managed. Chinese companies, for example, are hampered by inadequate qualification, incompetence, and lack of

authority of the board of directors, as well as ineffective performance verification. Without formal privatization, Tong concludes, the ownership restructuring is still incomplete. Most of China's SOEs, even the largest CAEs, have a way to go before getting to the top of world's large corporations.

As widely noted, China has attracted substantial inflows of foreign direct investment (FDI). In 2003 China replaced the United States as the world's largest destination of FDI. K.C. Fung, along with Busakorn Chantasasawat, Hitomi Iizaka, and Alan Siu, surveys the profile of China's FDI and investigates its external implications. They suggest that until 2002 FDI inflows in China came primarily from Hong Kong. Fung and his colleagues also address the question on the minds of many researchers as well as policymakers — whether China successfully attracts foreign firms at the expense of other Asian and Latin American economies. Drawing on statistics and existing studies, they find a positive association of FDI to China and FDI to other Asian economies. They attribute this association to the production-networking activities among various Asian economies as well as increased resource demands by a growing China. They conclude that there is no absolute diversion of FDI by China in East and Southeast Asia as well as in Latin America and that instead China has contributed to greater FDI inflows in other Asian economies.

However, there have been relative FDI diversions. The shares of FDI going to Asian and Latin American economies decline as more FDI flows into China. This in general, however, should not warrant an alarm. The best way to attract FDI, Fung and his colleagues suggest, is to follow standard economic prescriptions by pursuing low corporate tax rates, ensuring a high degree of openness, combating corruption and creating a booming domestic market.

Along with labor and capital, land is a basic production input. In China, land use has become a prominent economic and social issue in the recent years. John Wong and Liang Ruobing shed light on this inadequately studied issue by providing an overview of the evolution of land policies in China. Inappropriate land acquisition and land use policies are seen as a culprit for China's economic

overheating. Many large capital projects and new housing estates were been put up without due regard to proper land use procedures, contributing to economic overheating. The land misuse has severe social consequences. In the urban areas the existing land users or occupiers are evicted without adequate compensation, giving rise to many cases of disputes; in rural areas peasants can also fall victim to eviction without adequate compensation.

The government, according to Wong and Liang, falls back on direct administrative means to reduce unauthorized large investment projects. It has selectively used land policy and issued new regulations and directives to regulate land use and to contain widespread land abuses and related official corruption at the local level. The authority, however, is yet to take on one of the root causes of China's recent economic overheating, namely, the lack of clear-cut and transparent property rights provisions and effective land use regulations as well as ineffectual policy implementation. Over the longer run, the Chinese government needs to reconsider its land use rights in the rural areas by privatizing the land or transferring the ownership rights to peasants. This will enable low-income and poverty-stricken peasants to have a stake in the growing economy.

COPING WITH SOCIAL ISSUES AND TENSIONS

The most noticeable trademark in the Hu–Wen New Deal is the leadership's open and strenuous efforts to address outstanding social issues and reduce social tension. Although China's rapid economic growth in the past decades has lifted up the living standards of most of the population, the extent of material improvement varies across strata and regions. Some groups, including unemployed workers and grain-producing peasants, are lagging further behind the general rising living standard. A host of social problems, including income inequalities, stagnant rural income, cross-regional migration, inadequate social securities, and rising social disturbances have come to the political forefront. As these issues pose a genuine threat for China's political stability and legitimacy for the regime, they become the top priorities for the Hu–Wen leadership.

Lai Hongyi looks at rising income inequality, new social stratification and limits in social mobility, as well as Hu–Wen policies remedying these problems. He surveys existing research on these issues and finds that both income inequality and social mobility are rising steadily in China in the reform era. The Gini coefficient of per capita resident's income, for example, rose from a very low 0.288 in 1981 to a high 0.459 in 2001. China's social surveyors identify ten major social strata. China's middle class appears to be considerable, yet still small in size. It accounted for only 14% of the population in 2001 or 47% of the urban residents in 2002. Upward social mobility also remains limited due to a prominent influence by one's residency and parents' background. Increasing income inequality and restricted social mobility combines to produce social polarities and generates popular propensities for protests or conflict, constituting the most daunting social challenges for Hu and Wen.

According to Lai, in order to address rising income inequality and help promote upward mobility, Hu and Wen try to aid the very poor in the countryside and cities, increase financial inputs and support for grain-producing peasants, protect migrant workers in resettling and getting their pay on time. They also develop the western region and revive the northeast. Hu and Wen have also emphasized open procedures and merits in official promotion. These efforts have moderated at best the trend toward income inequalities and limited upward mobility, but have not reversed the rising trend.

In the reform era, China has witnessed a steep rise in labor mobility, which helps produce phenomenal growth in China's coast and urban areas. Zhao Litao examines labor market reform and related household registration (or the *bukou* system) in recent decades, especially under the Hu–Wen leadership.

According to Zhao, there have been two approaches to reforming the *bukou* system. During 1984–1997, efforts were made to de-link urban employment from urban *bukou* status and to grant temporary resident permit to rural migrant workers. However, the de-link approach resulted in segmented labor market and limited labor mobility. During 1997–2002 the authorities followed the *bukou*

reform approach by making urban *hukou* status increasingly accessible to rural residents, talents, and investors.

Dictated by their “pro-people” policy, the Hu–Wen leadership has acted to de-link social services from *hukou* status. The government also urges cities to lift unreasonable restrictions on rural migrants’ employment. It has cracked down on defaults on wage payments to peasant workers, emphasized respects for labor contract, mandated local inspection for migrants’ social security, stepped up vocational training of peasant workers, and asked local schools to admit their children of peasant workers.

These pro-people policies may have kind intentions. However, their implementation, as Zhao suggests, may be hindered by weak rule of law and local governments that are pro-business and are selective in enforcing central orders.

The most explosive form of social tension the Hu–Wen leadership has to cope with are the increasing incidents of disturbances. Estimates suggest that instances of unrest grew from 8,700 in 1993 to 58,500 in 2003. Cai Yongshun zeroes in on the issue and examines ties between citizens’ disruptive action and policy outcomes. Cai argues that citizen resistance is triggered by not only the government’s rights-violating practices, but also by risks and opportunities that government policies entail. The Chinese government clearly cannot tolerate disruptive action of a political nature. But its response to citizens’ non-political action has a mixed message. This invites disgruntled people to turn to a persistent, coordinated, and disruptive non-political action. In this case, the state’s technical responses of “divide-and-conquer” and a mix of sticks and carrots may not suffice and its policy responses addressing the sources of popular resentment are needed.

Cai suggests that the key causes of mass protests may be removed or weakened with the help of policy responses and progress of reforms. For example, completion of SOE reforms means no rapid expansion in the number of laid-off workers; rural-fee-for-tax reforms and phase-out of agricultural tax undertaken by Hu and Wen have reduced peasants’ fiscal burdens and their discontent. Since the early 2000s, the major cause for conflict in China has been

land use. Through mandating local government to compensate re-settlers, the central government has alleviated, if not eliminated, grievances. Ironically, Cai concludes, the Chinese government's solid reputation for not allowing political action may help it to maintain political stability. Disruptive action in China is thus manageable, instead of regime-threatening.

A major item of social policy priority for Hu and Wen is social welfare, security, and protection. The new leadership is clearly aware that an adequate social safety net can help to ease much of the discontent by groups that go under the market competition, ensure a secure life for citizens of all ages and maintain political stability.

Edward Gu provides a comprehensive overview on various welfare regimes in China since the late 1970s and highlights the one under Hu. According to Gu, China's old social welfare regime was composed of workplace-based urban welfare and marginalized-groups-oriented social welfare. China's social welfare reform has gone through two stages. From the mid-1980s to the mid-1990s, social policy reforms aimed to dismantle the mini-welfare state and re-build a social security system in order to cope with the fallouts from economic reforms. The state moved away from labor insurance for employees of SOEs and in the public sector and emphasized social insurance.

The second stage of reform began in the mid-1990s, as the state built social assistance and social insurance in order to reduce new poverty. This trend thickens in the Hu–Wen era. Under Hu and Wen, the government has increased coverage of social assistance, social pension insurance, social health insurance, job injury insurance, and maternity leave insurance in the cities. The government has also significantly increased funding for social assistance and tries to improve health care for peasants. Meanwhile, the government maintains its responsibility for social insurance to urban employees, has consolidated some social insurance schemes, and continues to strive for universal coverage in urban areas. At present, as in any country social insurance expenditures are much higher than social assistance expenditures in China. The ratio between the two expenditures,

however, has declined since 1999, signifying the rising significance of social assistance.

Health care profoundly affects the well-being of the population. China's health care reform has stirred up much controversy. In 2005, the media in China even characterized the reform with unusual candor as failed. Åke Blomqvist, an economist who has specialized in health care, provides a diagnosis of China's health care reform, discusses the respective roles of the government and markets, and proposes policy options.

Blomqvist outlines the health care reform in China in the recent years. In December 1998, China decided to establish a new urban social insurance program in order to replace the former schemes that covered government and SOEs employees. Enrollments in the program have been growing rapidly in recent years, with membership in 2003 exceeding 100 million, constituting more than 36% of urban employees. In rural areas, the central government wants to encourage a Cooperative Medical System (CMS), a rural equivalent of urban social insurance, but has made much less progress.

Blomqvist argues that since the health care sector is prone to market failure, the Chinese belief that free markets could work well for the health care system is flawed. He surveys a variety of effective and recommendable health care institutions. He recommends specific measures (such as utilizing private insurance and individual medical saving accounts) for China to strengthen the urban health insurance system, expand its coverage while maintaining its viability, and exercise price controls. He also suggests that health care for rural residents can follow a model based on CMSs with insurance that is built around township health centers and marketed to villages.

Finally, as the most populous country, China's demographic policies deserve attention. Peng Xizhe, a demographer and policy adviser for the Chinese government, provides a glimpse at demographic changes, and new demographic policies in China.

According to Peng, China has achieved positive records in bringing down the population growth and increasing urbanization. China also has its own demographic problems, including a huge

1.3 billion population, rapid population aging, a migrant population of 140 million, a rapid spread of AIDS, and an unbalanced sex ratio.

Against these new changes, China is remaking its demographic policies in several ways. First, the Hu–Wen leadership has treated the population issue in a much wider socioeconomic and environmental context. For example, national and local research projects on China’s population strategy have been launched through which demographers participate in the drafting of the 11th developmental plan. Second, population policy is implemented in closer association with other social policies. The state has conducted pilot programs in 15 provinces to reward peasants for obeying family planning in the past, earmarking the state’s efforts to enforce family planning through carrots instead of sticks. Third, local governments are granted more authority over regulation of local population. Fourth, the state has started to tackle the sex ratio imbalance that stood at 120 in 2000 by introducing a program known as “care for girls” and banning pre-birth sex identification and sex-selective abortion. Fifth, the state also protects the rights of rural migrants in the cities. Peng predicts that China’s current family policy will remain at the national level while provincial modification may occur.

MANAGING RELATIONS WITH THE UNITED STATES AND NEIGHBORS

The staggering political, economic, and social issues discussed above mean that the Hu–Wen leadership needs to focus on domestic affairs. In order to have the leisure of putting their “house” in order, they need a peaceful and smooth external environment. Thus, Hu and Wen need to manage well China’s relations with the United States, the sole superpower, as well as China’s neighbors.

Zhao Quansheng discusses Bush’s Asia policy in his second administration, as well as China’s foreign policy and the United States–China relations under Hu. The United States Asia policy, Zhao argues, only seconds to its policy toward the Middle East. Its Asia policy aims to fight terrorism, maintain peace and stability, and ensure trade and prosperity in the region. It also tries to

maintain a “hub-and-spokes” alliance in Asia and couch China into a pro-status-quo power. China, especially under Hu and Wen, has also adopted external strategies to facilitate its peaceful rise. It maintains close economic exchanges with the United States and assists with the United States over anti-terrorist campaigns, the North Korean nuclear crisis, and non-proliferation. Furthermore, it actively promotes regional economic integration, especially with the ASEAN. It utilizes the United States leverage over Taiwan to prevent the latter’s formal independence.

United States’s currently amicable policy toward China, however, does have its limits. It can be affected by change in perception about China, downturns in bilateral political relations, major setbacks in China’s domestic political and economic development, and Beijing’s cozy relations with “rogue states”. Thus “wary interdependence” best characterizes the relations between the existing super power and a rising one.

In terms of economic and political geography, China’s most important neighbors are in Northeast Asia. This topic is under close examination by Chung Jae Ho. He notes that since the early 1990s China has become increasingly open-minded, proactive and forthcoming towards regional cooperation in Asia. It has adopted the “good neighborly diplomacy”. Since the late 1990s, it has endorsed “great-power diplomacy with responsibilities” (*fu zeren de daguo waijiao*) and has been inclined toward agenda-setting. It has joined a dazzling series of regional initiatives, including the Greater Mekong Region Summit (GMS), the ASEAN Regional Forum (ARF), the Treaty of Amity and Cooperation, the China-ASEAN Free Trade Agreement (CAFTA), East Asian Think-Tank Networks (NEAT) and the Shanghai Cooperation Organization (SCO). China also played a leading role in resolving the North Korean nuclear issue.

Nevertheless, in contrast to regional cooperation involving Southeast Asia, regional cooperation in Northeast Asia, Chung observes, is hampered by functional, historical and structural limits and obstacles. Despite China’s proactive efforts to promote “peaceful development”, particularly under the helm of Hu Jintao, regional cooperation in Northeast Asia can hardly overcome its painful

memories and history. As a key player in the region the United States can also affect regional schemes and initiatives.

Compared to Northeast Asia, China's regional integration initiatives with Southeast Asia have proceeded much more smoothly. Zhang Haibing documents the new development in this area and frankly points out daunting challenges ahead. The year 2004 is of significance. ASEAN and China had started to decrease tariff rates on agricultural products, bilateral trade surpassed the US\$100 billion, and in November, the China–ASEAN Agreement on Trade in Goods was concluded. As a result, regional market integration has accelerated. In addition, institutional arrangements for regional economic cooperation have been formed. They include one highest cooperation mechanism, namely, the China–ASEAN Summit, as well as five working mechanisms. Moreover, their cooperation has now covered many areas, including agriculture, information and communication technology, human resource development, exploitation of the Mekong River, mutual investment, and the Pan-Asia railway.

China–ASEAN cooperation, Zhang argues, still faces daunting challenges. First, external risk exists in member nations' development model. Growth of China and most of ASEAN countries mainly depend upon FDI inflows from and exports to the United States and Western Europe. Second, most ASEAN countries and China have only limited capability to facilitate the full realization of benefits of Free Trade Area. Third, China-ASEAN Free Trade Area lacks a strong converging force.

III

CONCLUSION: FUTURE CHALLENGES FOR HU

In less than three years into their first administration, the Hu–Wen leadership has established a new and distinct style of governance. It projects a pro-people image and proclaims that the Party serves mainly the need of the populace. It has paid greatest attention to socio-economic issues, such as income inequality as well as plights of migrant workers and grain-producing peasants, land-losing

peasants, resettled urban residents and laid-off workers. It has also overhauled the Chinese bureaucracy and legal system and tried to make them more responsive to popular demands through introducing greater official accountability and limited democratic measures. Meanwhile, it has sustained China's high economic growth by deepening economic reform and integration with the world economy and pursuing an intensive and balanced model of growth through technological innovation and social equity. On the external side, it has declared to the world that China pursues peaceful rise and development. Hu and Wen have upheld multilateral and proactive diplomacy. It emphasizes building smooth and stable relations with its neighbors (with the only exception of Japan) and relies more on cooperative, confidence-building and pragmatic measures. The Hu–Wen New Deal has earned the leadership high marks at home and much attention abroad. Overseas observers, however, have reservations about China's lack of meaningful democratization measures and high-handed measures against popular legitimate protests and calls for faster political reform.

A question that naturally arises is what the prospects for the Hu–Wen leadership are, and what its future tasks and outlook may be. Here we are venturing into the unknown and treacherous territory for social scientists, i.e., predicting the future. However, given our knowledge about Chinese politics in recent decades and the findings summarized above and in light of the discussion of our contributors, several outstanding tasks and challenges can be identified.

The leadership will remain pragmatic but may become more diversified in the coming years. Having gone through the Cultural Revolution, China's new leaders are less ideological. Chinese leaders will continue to focus on domestic affairs. It will continue to pursue its New Deal by emphasizing social harmony, developing backward regions, helping out the poor, and making the government more responsive.

Specifically, it may also push ahead with political reform without undermining the one-party regime. The Party may want to introduce some form of checks and balance into the political system and

continue to improve transparency and enhance accountability. However, the leadership will find mounting political challenges in this process. It will have to maintain the legitimacy of a ruling party that is plagued by widespread corruption and will confront vested interests that have been firmly entrenched. Local agents of the state know better what is happening locally and are inclined to hide the negative information from their superiors.

The leadership will strive to maintain the one-party rule, instead of moving at full throttle toward democracy. One option for reforming the regime is to legitimize factions and turn some of them into political oppositions. The Party, however, may deem this option too radical to embrace it. Without democracy especially electoral democracy these changes may not address fundamental flaws of the political system. Ideologically, the Party may denounce western-style democratization and reject Washington Consensus as a fundamentally wrong economic agenda. The leadership, however, obviously lacks the skills to undertake necessary political changes.

The leadership as well as the Party, however, is not insecure. Even catastrophes like SARS could not topple the regime. The regime is thus quite capable of surviving adversities. Chinese leaders and their advisors are very history-conscious and are inclined to prepare for the worst. Past performance and experience suggests that outside analysts have constantly underestimated the CCP's ability to adapt to new challenges and containing immediate crises.

Hu may move to increase his power. He may do so without arousing opposition from other factions. One of the pressing issues for Hu in the coming years is to pick his successor. From our understanding, his successor is likely to have served as a provincial and central leader, would have college-level education or above, and would be under 60 when he replaces Hu in 2012.

Tensions between strata and within the society may rise and pose to disrupt social order. The leadership will continue to deal with rapid social changes, including aging population, income inequalities, the urban-rural divide, and inadequate social protection. It may continue to develop the backward regions and improve the state institutions in provisioning social welfare for the population.

China's leaders will also need to maintain economic growth in order to release economic stresses on the political system, such as unemployment and stagnant income growth for some groups and areas. The Party appears to have entered a social contract with the population — it will deliver high growth of 7%–8% a year in exchange for the population's support of its rule.

The Hu–Wen leadership will continue to pursue reform of the land use, financial system, and SOEs, upgrade technology and R&D, and develop backward areas. Japan appears to provide a negative example for China whose rapid growth is based on rapid expansion of manufacturing sectors. Japan is an international leader in high-technology. However, weakness in its banking and financial sectors has caused Japan's economy to plunge into a decade-long recession from which it is crawling out. China surely encounters the risk of slipping into economic recession, similar to Japan. The Chinese, however, have learnt a lesson from Japan and have started to reduce non-performing loans to avoid banking crisis. China will also have to contain the problem of possible unemployment, especially the structural one. Furthermore, China will have to reduce the reliance of its growth on foreign trade and heavy investment and promote growth that is based primarily on domestic demand, secondarily on domestic investment, and to some extent FDI and foreign trade. One increasingly urgent economic task for China is to fulfill China's WTO commitments. As China's 5–7 years of transition period for its WTO accession will expire in a few years, it has to ensure that its domestic producers and services sectors are ready to compete against strong counterparts from abroad. While this adjustment will yield positive economic gains in the long run, it is fraught with dangers in the short term. China will also have to face increasing competition from other developing countries, such as India which has sound corporate governance, stronger rule of law, better English mastery, and younger population.

To be able to concentrate on domestic affairs, the Hu–Wen leadership would continue to strive for a peaceful and friendly external environment. The most important pair of bilateral relations for China is its relations with the United States. China will strive for a stable

and strategic relationship with the United States and will try to ensure that crucial differences between them will not explode into direct confrontation. Recently, China has scored major progress in relations with Taiwan, reflected in visits by Taiwan opposition leaders to the mainland. China will also try to work with the United States to deter Taiwan *de juri* independence. Nevertheless, the risks for war across the strait still exist. Beijing also needs to figure out how to win hearts of the Taiwan people.

China will try to maintain friendly relations with its neighbors. China is likely to use six-party talks as a forum to discuss the Korean nuclear crisis and other major issues in Northeast Asia and institutionalize the six-party talks as a platform for Northeast Asian cooperation. Overall, China would like to advance multilateralism not only in the economic but also security arenas. The other trouble spot is China-Japan relations which may continue to be strained by Japan's atonement of its past war crime and its close military alliance with the United States targeting at a rising China. China may continue to advance cooperation with ASEAN nations. The United States may stay out of the East Asian Community building. However, its influence will continue to be felt and it can balance China's influence in the region. India may also become a new and important member in Asian regional integration.

China is poised to walk down the path towards a great power. It has the will to achieve the goal, is developing its capacity through rapid development and building its soft power, and is nurturing a positive perception from its neighbors through the discourse of peaceful rise or peaceful development. The Beijing Olympic Games in 2008 and the Shanghai World Expo in 2010 will provide China a great platform to project its high international status. However, to become a great power, China may need to overcome a previous great power's mistakes and avoid sacrificing small nations and applying double standards in its conduct of foreign policy. It needs to manage rising nationalism and prevent chauvinistic and victimized complexes in managing external affairs. Finally, it also needs to overcome structural flaws in its closed political system by introducing some form of election starting from the local level.