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China Policy Watch: Business Confidence
The Challenge Of Great Expectations

Reviving business confidence is a challenge and an opportunity for China's new leadership

One often hears that Chinese businesspeople only care about making money, and don't like to talk politics. This is rubbish: give them a chance and the promise of anonymity, and opinions flow faster than the *baijiu* at a government banquet. We did just that over the past month, as we conducted focus groups and surveys including over 30 executives at private, state-owned, and foreign companies in Beijing, Wuhan, and Hangzhou. We asked some questions about business performance and the economy, but our main focus was on policy and politics. And our participants engaged each other on the issues in conversations that we guided as lightly as possible.

Our goal was to get a sense of what business thinks about China's political transition, from the outgoing administration of President Hu Jintao and Premier Wen Jiabao to the new government of Xi Jinping and Li Keqiang. (As a check on our survey of the successful, we also asked questions of representatives of the toiling class—taxi drivers—in each city.) Although our small and non-random sample means that we cannot claim our survey results are statistically representative, we do think we have captured a sense of where views are heading in a way that is not available through more conventional surveys of business sentiment.

The new leadership starts with a clean slate, and clearly has an opportunity to revive business confidence. This will require substantive action: even among the most optimistic businesspeople we met, there is a strong sense that China needs to adopt major economic and political reforms. Opinions of the outgoing administration are low, and expectations of the incoming administration are high. So high, in fact, that one of the main challenges Xi and Li will face is not disappointing the enormous hopes businesspeople have already been placed on them. The gestures that the new leaders have made in the early days of their tenure have left a very positive impression. They are off to a good start, but business is watching to see if the first notes of music will lead to a new song or the same old tune.

Bordering on failure

Many businesspeople hold a very low opinion of the Hu-Wen administration

It is not politically correct to criticize officialdom in public, but that did not stop our respondents from doing so in private. When asked to grade the Hu-Wen government's performance on a scale of 1 to 100, respondents gave an average grade of 63—just barely above the minimum passing grade in China of 60. Although Hu and Wen got credit for rapid economic growth, they were skewered for a range of perceived policy failures. Responsibility for issues like corruption, pollution and poor protection for was all on their shoulders. The poor grade also reflects the low personal regard in which many executives hold the outgoing leaders.

Not surprisingly, executives from state-owned enterprises gave higher marks to their political masters than did those from private and foreign companies. One private executive said, "The last government could have done a lot of things, for example on civil service management and anti-corruption, but they didn't, and actually, they made things more of a mess." Most, but not all, foreign observers criticized the Hu-Wen team in extremely harsh terms: a "wasted decade," said one; "China went backwards," said another. One foreign respondent who gave a failing grade said that he was being generous compared to former premier Zhu Rongji, who "would give them a 1."

Low marks for the Hu-Wen government

Average survey response, by location and type of respondent

	Overall	Private firms	Foreign firms	SOEs	Taxi drivers
Beijing	53	52	53	65	56
Hangzhou	56	54	60	n/a	74
Wuhan	76	76	78	70	61

Question: "On a scale of 1 to 100, what grade do you give the outgoing Hu-Wen government?"

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Inland provinces have been booming, which helps explain Wuhan's higher opinion of the government

But the real variation was regional: companies in Wuhan gave a substantially higher grade to the Hu-Wen government than their counterparts in Beijing and Hangzhou. This seems to reflect big differences in the economic environment. While Hangzhou's exporters have suffered in the aftermath of the global financial crisis, Wuhan is still enjoying a huge infrastructure investment spree. Companies in Wuhan generally said the economy there was accelerating, whereas the sense in Beijing and Hangzhou was that things had slowed down from the high growth of earlier years. So when business is good, government gets a break; when business is bad, business blames government.

Economic reform: level the playing field

Executives have conflicted views about the government, wanting its help but also hoping it gets out of the way

Most businesspeople in China have a conflicted relationship with their government. They have plenty of gripes about the government—too much intervention, an uneven playing field, corruption—and many are quick to urge big changes. But they also rely on the state to carry out the policies necessary for future growth. As one of our respondents said, "many of those sitting in the room complaining about the government are also eating from its hand," and so are hesitant to accept fundamental change. Our experience backed this up: executives would in one breath praise new rules limiting official expenditures for banquets, and then in the other complain that as a result their businesses were suffering.

Confidence in the government's economic management, at least, seems solid. Our respondents were not terribly worried about the economy's overall growth prospects: most expect GDP growth for 2013 to be in the range of 7-8%. Over the next five years growth is expected to drop to 6-7%, which they did not see as a bad thing. The optimists believe there is still great potential for expansion, and see the incoming government's emphasis on urbanization and developing the service sector as creating the foundation for such growth. Those somewhat more skeptical about longterm trends still believe the government has a lot of levers to control the rate of growth, but they would prefer policies to do more to improve the quality of growth. The minority of more pessimistic respondents foresee a large drop off in growth after a year or two, due to rising debt and other systemic problems.

Executives see lots of challenges to changing their business models

Asked about their current business problems, many executives expressed concern that higher sales are not being matched by higher profits, even in relatively optimistic Wuhan. Our focus group participants there complained about the difficulties of high taxes, labor costs and overcapacity in many sectors. In every city, business leaders said that they recognize they need to shift from a strategy emphasizing boosting sales volumes to one based on innovation. But they also said it is extremely difficult in China to generate value from intellectual property. Some executives complained of the difficulty of enforcing contracts of any type, not just intellectual property.

Both SOE and private-company executives say SOE reform is needed, though they focus on different problems

When the conversation turned from problems to solutions, many executives emphasized the need for more reforms to state-owned enterprises. (By contrast, our taxi drivers were interested mainly in controlling inflation, in particular the prices of fuel and housing.) For our SOE respondents, the priority is improving how SOEs are governed internally—for example, by giving more rights to minority shareholders, or promoting employees based on talent rather than seniority and connections. But to those outside the system, reforming SOEs usually means reducing their monopolies and special privileges. "Fair competition" was mentioned again and again. As one respondent put it, "SOEs are the elder son, but it is the younger sons (private companies) that really take care of the family."

The other most common suggestion, even from the SOE respondents, was to reduce the government's intervention in the economy. For some, a common analogy is the need for government to be a "referee and not a player." When the government picks winners, companies waste time "figuring out how to get money out of the government's hands," one said. For others, less intervention means liberalizing prices for capital, utilities, and energy, which would reduce distortions in the economy and also help with environmental and efficiency problems.

Political reform: disinfecting with sunshine

Everyone sees corruption as a major problem, and increased transparency as a possible solution

On the issue of political reform, our business executives and taxi drivers were largely on the same page. Most respondents in all three cities said the most urgent task is tackling corruption. And the most commonly mentioned tool to do this is so-called "sunshine" rules requiring officials to disclose their assets. While a few respondents said China needs to institute democratic elections, not just government-managed "rule by law," most thought that an unrealistic goal. Some suggested that a more practical goal in the short term would be pursuing a range of reforms that increase transparency, including greater media freedom. Lastly, those respondents who complained about the strength of contracts stressed that the remedy is to make China's judiciary more independent and less susceptible to political manipulation. Our SOE participants were hesitant to discuss political reform in the focus groups, but in private were often equally critical, if not more so, of the political status quo.

The Challenge Of Great Expectations

The first gestures by the new leadership have been received very positively

Most executives have high hopes for the incoming administration

These high hopes could quickly sour if the new leadership team does not follow through

While our businesspeople did disagree somewhat about what changes China needs, they were nearly unanimous in expressing high hopes that the Xi-Li administration will bring about more change. In fact, all but two respondents gave higher marks to the incoming government than their predecessors. First impressions have been extremely positive: our respondents cited speeches and new policies about corruption, as well as Xi Jinping's symbolic trip to Shenzhen, a conscious homage to Deng Xiaoping's 1992 "southern tour" that marked the restart of economic reforms. They praised Xi's statement that in battling corruption, the party needs to "go after tigers and not just flies," and that the party itself needs to be subject to the rule of law.

High hopes for the Xi-Li government

Average survey response, by location and type of respondent

	Overall	Private firms	Foreign firms	SOEs	Taxi drivers
Beijing	69	70	63	80	72
Hangzhou	67	62	74	n/a	77
Wuhan	87	86	90	90	65

Question: "On a scale of 1 to 100, how much hope do you place in the new Xi-Li

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Although several believe that new anti-corruption chief Wang Qishan is the right person for the job, many are concerned that the problem is beyond any single person, no matter how tough and capable they might be. The few who gave the Xi-Li government lower scores than the Hu-Wen regime explained that it is mainly because the problems the incoming government faces are so much larger than those faced by the outgoing administration. As one respondent explained, "If they just don't backslide, that will be an accomplishment."

Our taxi drivers were on the whole less starry-eyed than the executives. These working-class cynics had only slightly more hope for the incoming government than for the old one. They tended to see all Chinese politicians as part of the same privileged class, putting on a show of anti-corruption drives and reforms that will not improve the lot of ordinary people.

After a decade in power, the disappointment and frustration with the outgoing Hu-Wen administration is palpable. Although economic growth has been strong, this seems to have come at the cost of diminishing confidence in both the government and the business environment. A key task for new leadership therefore will be to instill more optimism and confidence in Chinese businesspeople. Yet the high expectations already placed on Xi Jinping and Li Keqiang could be a double-edged sword. Business is clearly giving the new team the benefit of the doubt for the moment, which will increase their political room to maneuver. But these high expectations could also be easily disappointed if early slogans are not backed up by substantive reforms. As the new government tries to put China's economic growth on a more sustainable footing, it will need a confident business sector to keep investing in the future.