

POLICY MEMO

The Chinese Communist Party's Economic Challenge to the Free World

MILES YU

Senior Fellow, Hudson Institute and Visiting Fellow, Hoover Institution

April 2021

This memo is adapted from Miles Yu's testimony before the US-China Economic and Security Review Commission's hearing on April 15, 2021, "An Assessment of the CCP's Economic Ambitions, Plans, and Metrics of Success."

The Chinese economy and the philosophical roots of China's system have greater implications for the United States economy than many assume. This policy memo will examine the Chinese economy's distinct traits, how it operates, and why it thrives under a monopolistic government that exploits and challenges the global free market system, along with possible policy recommendations for the United States and its allies.

Chinese Paradox: A Communist Nation Participating in a Largely Capitalist System

The one critical fact to understand about the People's Republic of China is that it is a communist dictatorship ruled by a Marxist-Leninist party. The Party is dedicated to maintaining and strengthening its monopoly on all powers in the world's

most populous country and to mounting the most serious challenge to the free world since the Cold War.

However, unlike most other communist countries, China has been afforded the benefits of a global free-market system and enjoys largely open access to international trade, capital markets, and advanced technologies. The paradox of a communist nation fully participating in a largely capitalist system has enriched and strengthened the Chinese Communist Party (CCP), to the point where Beijing poses a mortal threat to the United States and to the international free market economic system that has enabled the rise of the communist state. The West played a role in creating the current state of play. But too many conversations in the United States focus only on our own strategic thinking. In his historic speech at the Richard Nixon Library in July 2020, former Secretary of State Mike Pompeo aptly described the situation and how we got here: "Our policies—and those of other free nations—resurrected China's failing economy, only

to see Beijing bite the international hands that were feeding it.” As President Richard Nixon admitted in his later years, his initiative to open up China in 1972 might have created a Frankenstein.

China's Capitalist Success is Built on Internal and External Exploitation

China is ruled by a dictatorial communist government that controls the Chinese economy and exploits the global free market system. Today, we see this most clearly in the CCP's ability to exploit the vast supply of cheap and skilled labor at its disposal. This workforce does not have meaningful labor protections such as the right to form and operate independent trade unions to exercise collective bargaining and welfare negotiations. In Xinjiang—the site of a tragic genocide against religious and ethnic minorities—laborers have been placed into camps and have no rights at all. The CCP has created a country-sized sweatshop, and the world is buying.

The Party's exploitation doesn't end with human capital. The Leninist centralized model of governance also means it can command the nation's immense material resources and effectively pursue high-capital-demand landmark infrastructure projects, such as the global Belt and Road Initiative. These projects include extensive highway and railway systems; wasteful and environmentally destructive housing and hydroelectric megaprojects; and of course, expensive weapons of war in the conventional and nuclear arenas, as well as asymmetrical areas like space, cyber, deep sea, and biogenetics.

The CCP's monopoly on power also allows Beijing to impose strict control over financial resources, forcing non-state businesses to rely on state financing and banking institutions. Any companies that dare to deviate from such reliance will end up investigated and fined like Jack Ma's Alibaba, whose demise is frequently covered in the news these days. What

happened to Alibaba should serve as a warning to investors looking to expand to the Chinese market.

In a similar vein, the CCP is unrelenting on implementing currency control measures and restrictions on currency flow, which make foreign investors often unable to send profits out of China. This creates a vicious cycle where investors have no choice but to continue adding more and more capital infusions into their Chinese investments. Foreign companies in China also face challenges unlike anywhere else in the world—access to Chinese consumers is often restricted, and the government-inspired and -encouraged xenophobia makes many foreign brands victims of enthusiastic national boycotts and mob hooliganism. While the advent of the Bitcoin age poses a challenge to all central banks, China views the digitalization of national currencies as an opportunity to increase surveillance of its own people and to upend the US dollar-dominated global trade settlement and transactional monitoring systems. It is taking ominous steps in exploring that opportunity.

Meanwhile, due to the lack of constitutional protection of private property and individual ownership, many Chinese who do not trust their government tend to move their money out of China. However, currency controls severely restrict Chinese citizens' ability to send money abroad. This creates a destabilizing factor for the global currency system, including rampant money laundering activities.

When the Chinese people succeed, the CCP feels threatened. Without constitutionally mandated private property protection, those who have financially succeeded in China often become targets of the central government for being too wealthy and too influential, subjecting them to arbitrary extralegal arrests and financial ruin. In the past 15 years, no fewer than 27 Chinese billionaires have been arrested – the charges range from the bizarre to the absurd. In the United States, we celebrate those who are financially successful on the Forbes

World's Billionaires List. In China, a listing on the Hurun Global Rich List is like being added to a hit list.

The Chinese Communist Party's Control of Information

The CCP, by its nature, has an innate urge to control the free flow of information. Transparency is anathema to the party, including economic data. The party sets arbitrary economic growth objectives based upon political impetuses, rather than credible economic numbers. This lack of transparency also endangers American investors, as many of the Chinese state-owned companies listed on Western capital markets provide vague and opaque information, often keeping their financial records hidden from regulators and investors in free-market countries.

Policy Recommendations

In closing, this paper will explore policy options that answer a question that Vladimir Lenin would have asked: "What is to be done?"

First and foremost, the United States should no longer ignore the enormous political and ideological differences between the CCP and the free world's systems. A fully free-market system of international trade cannot coexist peacefully with a "socialist market economy with Chinese communist party characteristics." We should face the reality and redress the biggest foreign-policy failure of the past half a century. It was based on the comforting but misguided view—popularized by political and economic elites—that China and the US could brush aside political and ideological differences, engage uncritically, and hope that democratic virtues and the free market system would eventually change communist China into a responsible stakeholder. Not only have we not changed the CCP with such thinking, the Party is now poised to change us. It is trying to remake the global order in its own image. There has been a great awakening on this issue, and there seems to be a bipartisan consensus that the old conventional wisdom was a mistake.

Policymakers in the United States must institutionalize this new awakening. Congress, the elected representatives of the American people, can play an important role here. During the last administration, the United States adopted a new emphasis of engaging China based on the principle of reciprocity. Economic reciprocity with China can be institutionalized through congressional action.

The first step could be item-by-item reciprocal responses to China's Market Access Negative List. This is also known as Special Administrative Measures for Foreign Investment Access, and constitutes a comprehensive list published annually by China's Development and Reform Commission that specifies all Chinese areas and sectors where foreign investments are allowed or not allowed. A reciprocal response would prohibit Chinese investments in the United States in areas such as high-quality agricultural seed, social surveys, humanities and social science research institutions, critical minerals mining, news organizations, radio and television productions, film studios, cinemas and theater chains, and cultural performance troupes, etc.

The second step should involve reciprocity for America's private companies. Congress could create a mechanism for them to register complaints about Chinese discrimination. The Chinese ban on Facebook and Twitter should not be a Facebook and Twitter problem, but an American problem. Based on this information, the US government could take sovereign reciprocal actions against China. As it is, too many American companies are effectively held hostage by the CCP. The companies hire the permanent class of China lobbyists and registered agents for China whose job is to sell corporate America access to senior Chinese officials so that they can continue making massive profits and not offend CCP autocrats. The piecemeal lobbying thus perpetuates America's corporate woes in the communist country.

The third step is for America to once again recognize the importance of global leadership. The economic challenge of



the CCP is not a matter of if we should or should not change Beijing's paradoxical economic reality. It is a matter of if we don't change its behavior, the free world will be changed by Beijing.

We are approaching the 100th anniversary of the CCP on July 1, 2021. Party leaders from Mao to Xi have repeatedly said their actions are guided by an epic struggle

of *nisiwohuo*, or “you die, I live.” The Party's shibboleth of win-win in US-China engagement is nothing but a grand deception. The CCP's inner core is based on the understanding that China's struggle with America and the free world is nothing but a zero-sum game. In a world of geopolitical great-power competition, the United States can, and must, win.



About the Author

Miles Yu is a senior fellow at Hudson Institute and a Visiting Fellow at Hoover Institution. He is also a professor of East Asia and Military/Naval History at the United States Naval Academy in Annapolis, Maryland. Dr. Yu specializes in Chinese military and strategic culture, US and Chinese military and diplomatic history, and US policy toward China.

Dr. Yu joined the Trump administration and served as the China policy adviser to Secretary of State Mike Pompeo. In that capacity, he advised the Secretary on all China-related issues, helped overhaul US policy toward China, and participated in key US government interagency deliberations on major policy and government actions with regard to China and other East Asian countries, including Japan, South Korea and Taiwan. From 2011-2016, he wrote the weekly column “Inside China” for the Washington Times. Since 1996, he has been an editorial consultant to Radio Free Asia, and a contributor to various media outlets including the *Wall Street Journal* and PBS News Hour.

Dr. Yu has published widely on topics in his field. His books include *OSS in China: Prelude to Cold War* (Yale University Press, 1997) and *The Dragon's War: Allied Operations and the Fate of China, 1937–1947* (Naval Institute Press, 2006). He is the author of many scholarly articles on China, military and intelligence history, and newspaper columns about contemporary Chinese political and military affairs. His numerous awards include the US Naval Academy's top researcher award, US Navy Special Action Awards, and US Navy Meritorious Service Award.

Dr. Yu received a doctorate in history from the University of California, Berkeley, a master's degree from Swarthmore College, and a bachelor's degree from Nankai University.

About Hudson Institute

Hudson Institute is a research organization promoting American leadership and global engagement for a secure, free, and prosperous future.

Founded in 1961 by strategist Herman Kahn, Hudson Institute challenges conventional thinking and helps manage strategic transitions to the future through interdisciplinary studies in defense, international relations, economics, health care, technology, culture, and law.

Hudson seeks to guide public policy makers and global leaders in government and business through a vigorous program of publications, conferences, policy briefings and recommendations.

Visit www.hudson.org for more information.

© 2021 Hudson Institute, Inc. All rights reserved.

Hudson Institute
1201 Pennsylvania Avenue, N.W.
Fourth Floor
Washington, D.C. 20004

+1.202.974.2400
info@hudson.org
www.hudson.org