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China: Big Changes Coming Soon

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Economic growth and political upheaval

BIG CHANGES ARE ahead for China, probably abrupt ones. The economy has grown so rapidly for many years, over 30 years at an average of nine percent a year, that its size makes it a major player in trade and finance and increasingly in political and military matters. This growth is not only of great importance internationally, it is already having profound domestic social effects and it is bound to have internal political ones — sooner or later.

Two kinds of changes are in store: political and economic. The order in which they occur will affect their impacts, and that order is very uncertain. In any case, big discontinuities are likely before 2020.

SOCIAL CHANGES

SOONER VERSUS *later* can make a large difference. It is one thing to believe that China's growth will lead eventually to political change (Deng Xiaoping told George Shultz in 1988 that China would become a democracy in 50 years, perhaps meaning: "Forget about it."), but is quite another matter to expect political change within this decade — an argument made here. But things are not so simple (they never are); another line of argument, discussed below, is that there is a good chance of an abrupt economic slowdown over this period. One should not expect these conjectured events to be independent; political turbulence would hurt the economy and a sharp economic slowdown would surely have political consequences. The interplay between these two prospects, a political disruption and/or an economic jolt, can only be a matter of speculation, and some is offered here.

The leading edge of the time when these events might occur, assuming continued high-speed growth, is 2015 — soon enough to get our attention — with the odds increasing in successive years. The common factor that connects them is that China will reach a GDP per capita level of \$17,000 by about then (in 2005 purchasing power parity). This is the level at which all non-oil-rich countries are at least "partly free" as rated by Freedom House, with the large majority being "Free." Also fostering freedoms is the level of education, and that too is steadily increasing in China. While today it is deep in the "non-free" category, assuming growth is sustained at nine to ten percent a year it will reach this freedom benchmark level by 2015; if growth slows to seven percent annually, as Premier Wen Jiabao has suggested it will, that level is reached not long after — by 2017. (To be more precise, with continued high growth there is a 50–50 chance of China being declared partly free by 2017, odds that will increase thereafter.)

Most discussion on this topic focuses, understandably, on political freedoms, the ability of a people to choose their rulers. But Freedom House has two freedom indexes: One is on political rights while the other is civil liberties (for the latter, think of the U.S. Bill of Rights). On these measures, China today has a bottom score on political rights and is rated one step above the bottom on civil liberties. There should be no argument about the political rating; it is a Leninist state in which the Communist Party has combined economic liberalizing with tight political control. But economic liberalizing is having profound social consequences. Its foundation is prosperity. Prosperity is decidedly unequally divided, but a large middle class has emerged centered in the cities in the eastern part of the country, there is a growing private sector, the press is freer than a decade ago and much freer than 30 years ago (but with political speech remaining decidedly unfree), the labor market is more open, urban residency permits are less binding, religious practices are often harassed but are widely tolerated, the legal system crawls ahead, and people have a growing sense of having rights (not a traditional Chinese value). Prosperity may be decidedly unequally divided but, again, a large middle class has emerged centered in the cities in the eastern part of the country. In Freedom House terms, these advances mean progress on civil liberties.

On the negative side, recently there has been a crackdown on dissent with the official euphemism being "stability maintenance." It isn't clear why this is happening given that Party control looks strong. The transition to the next set of rulers next year seems to be settled, while many of the mass demonstrations that occur are taking place in the non-Han periphery of the country. It is true that worries are expressed by officialdom about the political turmoil engulfing the Arab world spreading to China, and memories about the events in Tiananmen Square in 1989, which are no doubt vivid in the minds of Party leaders, must also be playing a role. They were triggered by the upheavals in Eastern Europe, which culminated in the collapse of the Soviet Union, and were seen as jeopardizing the rule of the Party. If you are running a Leninist operation you can't be too careful.

Unfortunately, China has recently cracked down on dissent with the official explanation being "stability maintenance."

China's situation needs to be put into the worldwide pattern, which shows a strong correlation between economic development and democratic freedoms. Three possibilities might account for this connection: 1) Development might lead to democracy; 2) democracy might foster development; or 3) there might be a common cause driving both. The first, development leading to democracy, is Seymour Martin Lipset's hypothesis that only a society with educated, wealthy people can resist the appeal of demagogues. Stable democracy presupposes an accumulation of human, social, and physical capital. Education promotes growth, and schooling makes democratic revolutions against dictatorships more probable and successful antidemocratic coups less probable.

After analyzing more than a hundred countries, in support of the Lipset view Robert Barro found that higher incomes and higher levels of (primary) education predict higher freedoms — but with significant time lags between the appearance of a factor positive for electoral rights and its expression in politics. On education, in 2000, China's over-25 population had an average of only 5.74 years of schooling. Large educational-improvement efforts are underway, especially in rural areas and in the rapidly expanding postsecondary sector. By 2025, the average Chinese person over 25 will have had almost eight years of formal schooling. The educational mill grinds slowly but over time has huge effects. Barro attributed such lags to inertia in institutions affected by changes in economic and social variables, and notes that after about two decades "the level of democracy is nearly fully determined by the economic and social variables."

This observation helps one to understand why a rapidly growing country such as China has a freedom rating today well below the level that its current income would predict.

Adam Przeworski and his coauthors also find that levels of economic development best predict the incidence of various types of political regimes, but their interpretation is the superior survival capacity of wealthier democracies rather than to movements from dictatorship to democracy at higher levels of wealth. The higher the level of income that a given country enjoys, these researchers note, the better are the odds that a democratic regime in that country will endure.

People in the Chinese Communist Party are feeling fewer inhibitions about airing their grievances, which are numerous.

Barro and Przeworski are among those who find that democracy does not lead directly to higher growth, a view reinforced by Torsten Persson and Guido Tabellini, who believe that the evidence that democratizations yield economic growth is weak. They write that "democracy" is too blunt a concept and that institutional details matter greatly. The theoretical picture remains unclear and the literature is divided.

The third possibility, that democracy and development have a common cause, finds support from Daron Acemoglu and his several coauthors, who argue that "though income and democracy are positively correlated, there is no evidence of a causal effect. Instead . . . historical factors appear to have shaped the divergent political and economic development paths of various societies, leading to the positive association between democracy and economic performance." These scholars see political and economic development paths as interwoven. Some countries embarked on development paths associated with democracy and economic growth, while others followed paths based on dictatorship, repression, and more limited growth.

Whichever interpretation one adopts, a democratizing China would not be unusual in East Asia, with Japan, South Korea, and Taiwan rated "Free" and Singapore rated "Partly Free" by Freedom House. They show that Western-style democracy can take root in Sinitic societies.

The Chinese Communist Party has allowed a small window for elections for political office. In 1988 it mandated them, but only for villages. By the mid-1990s, 90 percent of committee heads held their posts by virtue of the ballot. However, requirements such as the direct nomination by individuals, multiple candidates, secret ballots, public counting of votes, immediate announcement of results, and regular recall procedures are not always followed. Some years ago it seemed likely that elections would be extended upward to townships, but this has not happened.

This is creating a changed situation for the Party, with people feeling fewer inhibitions about airing their grievances, which are numerous and can be triggered by events in which the authorities are held at fault. One such case was their response to a high-speed train accident in July 2011. The accident was bad enough, but what enraged many people was the authorities' attempted cover-up (literally: hastily trying to bury the fallen cars and bodies).

One of the ways the people express their discontent is through what the authorities call "mass incidents." These are, inter alia, a mixture of strikes and protests against unjust behavior by the police and the seizure of land from peasants by local Party people who then profit from it, and incidences in which non-Han people object to discriminatory behavior. In 1995, about 10,000 such incidents were reported; a decade later the official figure had increased tenfold. The government has stopped reporting this number but an unofficial estimate for 2010 is 160,000. Protesters typically avoid direct challenge to Party authority, preferring to cite rights listed in Party documents, laws, State Council regulations, and speeches by Communist Party leaders. Protests also tend to be carefully limited to local matters. One should not assume that protests in the countryside seriously threaten the regime. People know the role of protests in their history — and of leaders sometimes encouraging them as a way of ferreting out corrupt local officials. Yet while this is not a sign that the Party is tottering, neither is it a sign of Party legitimacy.

The nervousness the authorities are displaying reflects the profound changes occurring in society. As Geoff Dyer wrote in October 2010 in the *Financial Times*:

Jailed for 11 years for organizing a pro-democracy petition, Mr. Liu [Xiaobo] is a standard-bearer for political reform but in many ways he is not the main challenge for the authorities. . . . Mr. Liu is part of an older generation of dissidents who have been marginalized since Tiananmen. Few ordinary Chinese have heard of him.

Instead, the pressure is more diffuse but from a broader range of sources. There are the well-to-do suburban residents who happily organize large protests when their property rights are affected and make sure television cameras are there to watch them. China's fast-growing legal community is full of people — from judges to citizens with a grievance — who are trying to build more independent courts.

And then there is the Internet, which, in spite of all the efforts of the authorities to censor and mould discussion, is also a deep well of rebellious irony

The Chinese party-state is such a blizzard of activity, that it is often easy to overlook the increasingly vibrant society emerging from behind its Leninist shadow.

The Party is indeed in a blizzard of activity, summarized as follows by Edward Steinfeld, writing in the July-August 2011 issue of the *Boston Review*:

In this new system state authority and the nature of state-society relations are radically different, a reality confirmed by the state's frenetic effort to develop new rules to maintain control and influence. As a response to changing expectations of the role of the state, a new discourse of law-based governance has emerged. In addition to new tax, contract, property, and environmental laws, the state has promulgated national regulations on open government information — China's Freedom of Information Act, in a sense. Some provinces, such as booming Fujian, have new labor rules that emphasize collective bargaining.

There are differences in tone among the public statements of some leaders on the subject of its political future. Many Party elders have come out against censorship and in support of freedoms of speech and of the press. As for active authorities, Premier Wen Jiabao said in an interview with CNN that "the people's wishes for and needs for democracy and freedom are irresistible" (a statement that was censored in the Chinese press).

Technology is transforming people's access to information and their ability to communicate with each other. One is the ubiquitous cell phone, with around 850 million of them in use in China today, with over a billion users projected a few years from now. With over half a billion text messages flowing daily, the government has lost control of people's ability to spread the word (e.g., about the next SARS-type epidemic), organize protests, or expose corruption. Cell phones are an organizing instrument for mass demonstrations triggered by disturbing events.

The importance of the Internet should not be doubted. It has about 500 million users in China and is also heading powerfully upward. Because other sources of information and entertainment have been more limited than in most other countries, its social impact is greater. This has produced an ongoing game between users who seek information and who blog and the censors who try to set strict limits. The leaders' nervousness was recently displayed in an absurd way in reaction to the uprisings in the Arab world. Because the Tunisian revolutionaries dubbed their successful uprising the "Jasmine Revolution," this flower for a while became a nonexistent plant. In February, when messages for a Chinese "Jasmine Revolution" began circulating on the Internet the Chinese characters for jasmine were intermittently blocked in text messages; videos of President Hu Jintao singing "Mo Li Hua," a Qing dynasty paean to the flower, disappeared from the Web.

Demonstrations of people power via the Internet or the use of cell phones violate a tenet of Leninist control: keeping individuals separated by geography and by social class. All this modernization is being permitted (up to a point) by the authorities because of the economic benefits these social networking technologies bring; the country's growth would be impaired were they to be more rigorously restricted.

ECONOMIC AND POLITICAL DISRUPTIONS?

SO HIGH-SPEED GROWTH, seen as necessary by Party leaders if they are to remain in control, is sowing the seeds of their downfall. But will China's high growth rate be sustained? It is axiomatic that the rate of 9-plus percent per year will slow; trees do not grow to the sky and 30 years of high-speed growth (interrupted briefly by the Tiananmen Square events in 1989) is already exceptional. A common view is that the slowdown will happen gradually through more sluggish growth in the work force, a reduced flow of workers from low-marginal-productivity farming to higher productivity urban work, and the country's approach to the world technological frontier.

A contrasting view is offered by some scholars, recently by Barry Eichengreen, Kwanho Shin, and Donghyun Park. They find that high growth in almost all non-oil-exporting countries came to a rather sudden end at a per capita GDP of \$16,740 in 2005 international prices, with growth slowing from 5.6 to 2.1 percent per annum, and they note that China is on a trajectory to reach that level in 2015 (or 2017 if growth is seven percent a year). They estimate the coming slowdown to be two to 3.5 percent a year, which would take the nation's growth rate down to around six to seven percent a year (an eventuality the authors present not as certain but as highly probable). The basic reason is that at that level of GDP the payoff from shifting workers from agriculture to industry decreases and so, too, do the benefits from using foreign-developed technologies. Contributing further to the slowdown will be China's strongly undervalued exchange rate. The three authors observe that the only two fast-growing economies to sail through the \$16,000 level unimpeded were the city-states of Hong Kong and Singapore.

Central to this phenomenon is a slowing of productivity growth. They write:

Slowdowns coincide with the point in the growth process where it is no longer possible to boost productivity by shifting additional workers from agriculture to industry and where the gains from importing foreign technology diminish. But the sharpness and extent of the fall in TFP (total factor productivity) growth from unusually high levels of 3-plus percent to virtually zero is striking.

However, in this circumstance China has a unique advantage that could keep it growing at a good rate: a vast region into which capital investment can be poured. Its Western provinces are both highly populated and poor. On this point, the authors write:

If the growth miracle is transplantable within China, then the economic development of the interior provinces, which have larger populations than most countries and are home to a substantial fraction of China's own population, can continue to sustain the country's growth for years to come. The government is already extending physical infrastructure, such as highways and railways, to less developed provinces to prepare them for this transition.

Assuming an abrupt slowdown does occur, though, what might some of its consequences be? Domestically, much might depend on the sectoral and geographic distribution of the slowdown. Already, much capital investment at the margin probably has little return. This is likely true of much of the reported \$300 billion spent on high-speed rail. Might the government respond by cutting some kinds of capital investment (which it should be doing

anyway) and encouraging consumption, which has fallen to a remarkably low 36 percent of total output? It has said it wants to do this.

It has become almost axiomatic that the stability of China, indeed the legitimacy of rule by the Party, requires sustained high growth — a minimum of seven percent per year GDP growth. Although the existence of a magic threshold isn't credible and that rate, almost anywhere else in the world, would be seen as excellent, markedly slowed growth would likely have consequences for China, domestic and foreign.

Domestically, the prospect of slower growth raises many questions. For example, what would the differential impact of slower growth be across the income distribution, which has substantially widened over time? Some of the rich and powerful are flaunting their wealth, and the Internet is displaying this for all to see. How would this consumption come across if times get tough?

What economic sectors would be most affected? Already a real estate bust is in the offing, with rising unemployment for construction workers. What would happen to the auto sector, the world's largest with more than eighteen million vehicles sold in 2010 and officially forecast to reach 50 million by 2021? What might happen to unemployment and underemployment, already a problem, including for college graduates? How might people react to disappointed expectations? Would disaffection with the Party, which is not universally admired, grow markedly?

On possible international impacts, Eichengreen and his colleagues have something to say: "By some estimates, China alone is accounting for 30 percent of global demand growth, the BRICs [Brazil, Russia, India and China] collectively 45 percent, and emerging markets and developing countries as a whole a healthy majority of the total." In short, such a Chinese slowdown would seriously impact world growth.

Most obviously affected would be raw material suppliers such as Brazil, Indonesia, and Australia, but also machinery suppliers in Japan and Europe. Given the multilateral character of world trade, U.S. exports would also be hurt.

China's defense and foreign policy could be affected in several ways by a major economic slowdown. Slowed growth implies its future military potential will loom not so large. The country would find it more difficult to afford the wide array of advanced weapons many assume it will have and which the People's Liberation Army doubtless expects to receive. If the nation's woes are deep enough, the Party might be tempted to blame outsiders for its misfortunes. The prime target here would be the Americans.

The Party has the option of trying to avoid a possibly major upheaval by gradually introducing political changes from the bottom. This is what the Kuomintang Party, once also a Leninist one, did in Taiwan. Political choices were introduced first in local government, then in the national parliament, then finally in elections for president. This proceeded not without difficulties but relatively smoothly. China has not followed this upward course perhaps because the Party leadership sees the threat to its control as too great or perhaps because of a belief that political chaos would result. One hesitates to criticize such great experts on power as China's leaders, but it does look like big trouble could be ahead.

THE INTERPLAY BETWEEN DISRUPTIONS

TO RETURN TO the initial propositions: There is a significant chance of either, or both, political and economic change in China occurring at some point before 2020. If this change happens, the order in which these two events occur could make a major difference, although one can only guess at how events might play out. If substantial political liberalizing were to occur first, then a less-than-huge economic slowdown shouldn't have a traumatic effect. But if it were to happen the other way around, if economic change comes before political change, then a sharp economic slowdown might result in political liberalizing, or a conservative faction might succeed in tightening the screws, or there might be an extended period of political turbulence. We simply don't know.

One way or another, developments in China in the next decade have a high probability of deeply affecting the rest of the world — more so than they have already and in very different ways.

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