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## Coming out

Mar 23rd 2006

From The Economist print edition

AP



**China hopes to use the 2008 Olympics in Beijing to mark its emergence on the world stage. But, says James Miles (interviewed [here](#)), it still has plenty of things to fix at home**

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"CHINA is a second-rank middle power that has mastered the art of diplomatic theatre: it has us willingly suspending our disbelief in its strength." So argued the late Gerald Segal, a British scholar, in 1999 as the country reeled from the Asian financial crisis and fumed impotently as NATO attacked Serbia. China was then merely "a theoretical power", and seriously overrated in terms of international trade and investment. Mr Segal made a powerful case that China mattered far less than many believed. Today it is hard to dispute that China matters far more than it did seven years ago.

Yet there is no other important country whose likely trajectory over the next 20 years is more uncertain than China's. Possibilities include:

- An economy that continues to boom as the political system gradually becomes more liberal and China becomes an increasingly positive force in the world;
- A fast-growing economy, a surge of vengeful nationalism and an attempt by China to displace American power in Asia, regain Taiwan and challenge Japan;
- A country in disarray, engulfed by social and political crises as its economy slumps.

All are plausible. Much will depend on choices made by China itself and by other powers, especially America.

That China does matter is evident from its impact on the global economy. Since 2000, China's contribution to global GDP growth (in purchasing-power-parity terms) has been bigger than America's, and more than half as big again as the combined contribution of India, Brazil and Russia, the three next-largest emerging economies. China's massive build-up of American Treasury bonds affects American interest rates and thus Americans' willingness to spend. Its low-priced manufactures give western consumers more buying power. Its thirst for energy has helped push oil prices to record highs. Its entry to the World Trade Organisation in 2001 has speeded up the opening of the world's biggest market. Whereas a few years ago it might not have mattered much to the West if China's growth had faltered, today it would be a very different story.

China's growth and increasing confidence is also beginning to affect the way it behaves on the world stage. If only tentatively so far, it is beginning to act like a big power. A country that once preferred to stay clear of multilateral diplomacy is now at the centre of multilateral efforts to persuade North Korea to abandon its nuclear-weapons programmes. It has formed a club of central Asian powers to deal with security threats. Its secretive armed forces are reaching out to other countries by staging joint manoeuvres (though not yet with the Americans or the Japanese). And China's burgeoning demand for oil and other commodities has made it cosy up to countries whose unsavoury behaviour matters to the West, such as Iran.

Over the next few years China's Communist Party leaders will face a series of challenges. Abroad, perceptions of China will change as the country's surging economy affects the lives of people around the world. In places that are important to China, from Tokyo to Taipei to Washington, DC, there will be changes in political leadership. At home, rapid growth will bring social and economic turbulence. And next year there will be an important quinquennial party conclave, followed by the Olympic Games in Beijing in 2008.



The world is expecting more of China, and so are its own people. This will become increasingly clear in the build-up to the Olympics. For China, these will be about far more than sport. They will be much the biggest international event ever staged on its soil: a coming-out party of huge symbolic importance. They will mark China's full rehabilitation in Western eyes after the bloody suppression of the Tiananmen Square protests in 1989. They will also be a chance to show off what the chief day-to-day organiser of the Beijing Olympics, Liu Jingmin, calls "an industrial revolution on a much bigger scale than Europe's". Ambitiously, in a country that has one of the world's smoggiest capitals, Mr Liu says he wants a "green revolution" too.

## A property-owning non-democracy

Accompanying China's industrial transformation has been another revolution of profound significance. Since the late 1990s, urban China has privatised housing, a commodity once exclusively in the hands of the state. A property-owning middle class is not only fuelling a surge of consumption but also developing a keen desire to protect its property. Few see much benefit in trying to overthrow the party: that, they fear, could cause chaos and an even bigger threat to wealth. But many want better governance and a legal system that protects them. And all but the very richest complain bitterly about a government that, despite strong and growing revenues, has presided over the collapse of affordable health care and education.

Farmers want change too. The past few years have seen an upsurge of peasant protests, many of them about the rapid encroachment of cities into rural land. As this survey will argue, China needs another ownership revolution, this time in the countryside. One of the most damaging and socially divisive legacies of Maoist economics is the control of rural land by village "collectives". The rights of farmers in these collectives are ill-defined. In practice, rural governments regard the land as theirs and use it to fill their coffers. Many millions of farmers have been pushed off their fields with little if any compensation, and anger is growing.

President Hu Jintao, who in 2004 assumed full authority in the communist country's first ever peaceful handover of power, has set his sights high. Abroad, he wants to convince the world that China's rise poses no threat to other countries. At home, he hopes to create a "harmonious society". This means one less obviously riven by huge disparities in wealth and access to services such as schools and hospitals, and one less troubled by protests.

The party conclave late next year, known as the 17th Congress, will be the first such gathering with Mr Hu in undisputed command (insofar as anyone can tell in China's opaque political system). It will be an important opportunity for him to indicate how a still unreformed and dictatorial party can give the public a greater say in addressing these growing social problems. And it will be a chance, less than a year before the Olympics, to show the world that against the background of China's remarkable economic change, the party is changing too.

Political reform matters. Without it, it is hard to imagine how China could make the kind of stable transition to democracy that Taiwan has achieved; and an unstable China is more likely to pose a threat to the outside world. The past few years have seen signs that the party wants to use nationalist sentiment to bolster its legitimacy. The dangers of this approach became evident in 1999, with an explosion of anger across urban China about the accidental bombing of China's embassy in Belgrade by American warplanes. Last year similar outrage was directed at the Japanese, with sometimes violent protests in several cities triggered by territorial disputes and Japan's wartime history. Such unrest worries other countries, and it worries China's Communist Party too, even though it plays a large part in fuelling it.

The Bush administration is trying to cajole China away from seeing the global balance of power in zero-sum terms and persuade it instead that a rising China and a strong America could not only coexist but thrive together. In September last year, Robert Zoellick, America's deputy secretary of state, said he hoped that China would be a "responsible stakeholder" in the world community. That has now become one of America's favourite terms in its discourse with China. It means that America wants China, a veto-wielding member of the United Nations Security Council, to look beyond its narrow self-interest in its international dealings. China's handling of the nuclear crisis in Iran will be an

important test. Reassuringly, at least in its relations with America, China for now seems to be guided more by pragmatism than by competition. And just as reassuringly, America is encouraging it in this.

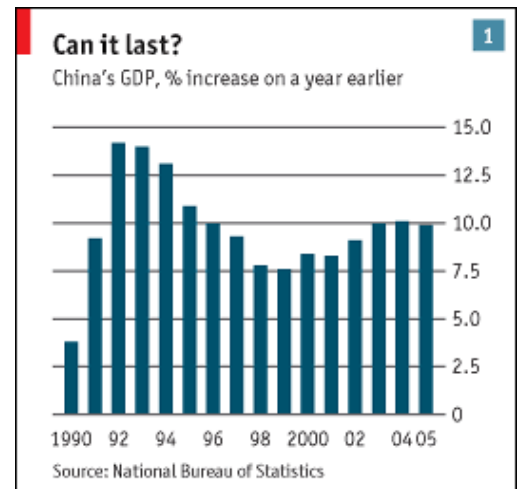
Barring a sharp slowdown in the global economy or some huge crisis at home, China is likely to maintain strong growth for the remainder of this decade. This gives its leaders more leeway to sort out its banking system, deal with the land-ownership problem, fix health care and education (which will involve big changes in the country's fiscal system) and set up a credible social-security safety net. If it fails to do so in the next few years, it will store up potential crises for the decade beyond, when China's working-age population will begin to decline and a rapidly ageing society will loom closer.

## Beware of Latin Americanisation

Efforts to tackle such issues are motivated by fear of unrest. Officials are well aware of China's vulnerability to the sort of sudden political crisis that caused the collapse of communist governments in Russia and eastern Europe less than two decades ago. In the official media, a fashionable new topic is the potential "Latin Americanisation" of China: the possibility that growing income inequalities and an ill-regulated rush to privatise could precipitate economic and political upheaval. Just as the implosion of communist regimes elsewhere encouraged the late Deng Xiaoping to launch wealth-generating market reforms in the early 1990s, fears of instability caused by today's inequalities at home are prompting the government to try to find ways to help the marginalised.

This survey will argue that such fears are sometimes exaggerated by a party that until 15 years ago controlled almost every aspect of its citizens' lives. The party is finding it hard to adjust to what many developing countries would regard as normal teething troubles. China's rapid economic growth endows it with a critical mass of people who expect their lives, or at least those of their children, to get much better in material terms than seemed possible until quite recently. Reports of protests here and there have become part of the background noise of urban life.

But rapid economic growth cannot be expected to last forever, and the party is acutely aware that, apart from its ability to deliver wealth to some, it lacks a strong legitimising force. Conscious of the country's volatile history, it is especially alarmed by the growing unrest among a rural population (still the majority) that has benefited far less from China's economic rise than have many urban residents. It was after all, a peasant rebellion that helped the communists to power. And although it is safe to rule out another such revolution, rural discontent is nevertheless a big political challenge for Mr Hu.





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## Fat of the land

Mar 23rd 2006

From The Economist print edition

### But only for a select few

IN PINGGU district, a mountainous and largely rural area in north-eastern Beijing, local officials are keen to show off how they are implementing one of the Communist Party's latest directives. It is, like all party initiatives, encapsulated in a slogan: "Promote the construction of a new socialist countryside." The idea is to narrow the widening gap between rural and urban China, defuse unrest and turn the country's 800m rural residents into economy-boosting consumers.

In Bolitai Village, perched on a slope beneath the scenic ruins of the Great Wall, building a "new socialist countryside" has meant bulldozing peasants' decrepit houses and replacing them with cheery-looking two-storey villas with solar heating panels on the roofs and broadband internet access. Pinggu's plan is to enrich remote village communities by turning them into weekend hideaways for a new middle class in Beijing that now has cars and thus the means to roam. The government provides grants and arranges low-interest loans for construction, and encourages lots of official delegations to visit.

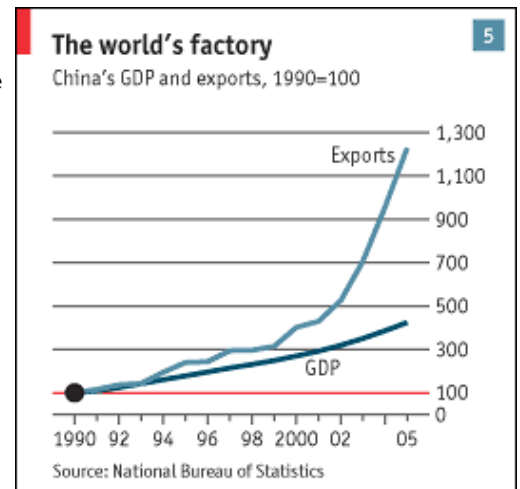
The revamped Bolitai looks garishly new, and insofar as it involves an entire community falling in with a government-inspired project (barring one old man who has refused to rebuild his house), it has the feel of Chinese socialism. Pinggu officials boast that their "new socialist countryside" campaign got started before the idea became party policy last October. The party plans to boost spending on rural infrastructure including roads, schools and hospitals, abolish all school fees by the end of next year and step up efforts to provide peasants with health insurance. But none of this will tackle the root of China's rural problems: the ownership of land.

Reports of large-scale and sometimes violent rural protests have become ever more frequent in recent months. In June 2005, government-hired goons in Hebei Province killed six peasants in a battle to enforce a claim on a piece of farmland by a state-owned power plant. The following month, hundreds of villagers in Taishi in Guangdong province launched a campaign to oust their village head whom they accused of misappropriating money from land sales, leading to violent clashes. In December, police shot dead as many as 20 villagers in Dongzhou in Guangdong province in another fight over land claimed by a power plant. In another Guangdong village, Panlong, a girl was killed in January when police clashed with farmers.

At a party meeting in December, China's prime minister, Wen Jiabao, reflecting the leadership's growing anxiety over such unrest, issued a warning against making "historic errors" over rural land. The protests suggest that the party's strategies for taming rural unrest have failed. In the 1990s, one answer was thought to be village democracy. Residents were allowed to elect their leaders by secret ballot. But in many villages the experiment dissolved into power struggles between elected chiefs and the party's own unelected representatives. The party made it clear that the party secretaries were to remain in overall command, and the peasants' enthusiasm dwindled.

Another strategy has been to boost rural incomes. In 2000 the party began to abolish a wide range of fees levied on farmers by local governments. In 2004 it offered farmers direct subsidies for

growing grain. From this year, it has abolished an ancient tax levied on peasants according to the amount of land they hold. Real rural incomes in 2004 grew by 6.8%, the highest annual rate since 1996, and in 2005 by 6.2%. But urban incomes last year rose by 9.6% and, especially on the periphery of urban areas where land is being seized fastest, there is still much anger and resentment in the villages. Estimates vary, but most agree that tens of millions have lost some or all of their land since the early 1990s, often without compensation.



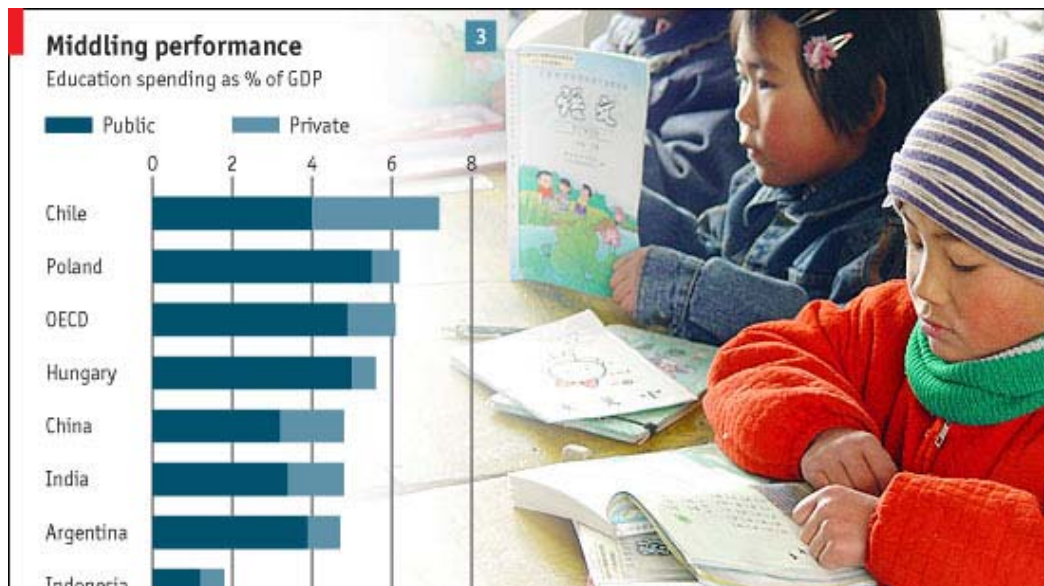
## Not for keeps

The problem goes back to Mao Zedong. One of the first things he did on taking power in 1949 was to seize land from landowners (killing thousands of them in the process) and redistribute it to peasants. In the 1950s he took the land away from them again and put it under the "collective" ownership of communes. The communes were dismantled in the early 1980s, a few years after Mao's death. Peasants were allocated plots of land to farm as they wished, but ownership remained "collective". Since the 1990s, leases of 30 years (but in practice often less) have been granted on these tiny plots, but peasants have not been able to use the land as collateral for loans or to sell it. They can rent it out, but this often involves paying a fee to the village administration.

So whereas trade in land and property has become an important engine of growth in urban China (where residential leases run for 70 years and others for 40 or 50), farmers have been cut out of this boom. Li Changping, a former township party chief who has become a prominent critic of the government's rural policy, says that by limiting leases to 30 years the state is in effect asserting its control of the land over the village collective. This reinforces local governments' belief that land is theirs to grab.

China's rural-land problem is exacerbated by a dysfunctional system of fiscal transfers that leaves many local governments unable to pay for basic services such as health care and education. China is among the most decentralised countries in the world as far as paying for local services is concerned ("the central government invites the guests, the local government pays the bill," goes a popular saying). A half-baked attempt at reform in 1994 has favoured wealthier regions.

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Abolishing rural taxes without putting in place an alternative way of funding public services has simply made the problem worse. Land has become an even more vital resource for local governments, which either hand it over for little or nothing to attract industry or sell it at high prices to property developers. They also use requisitioned land as collateral for bank loans, adding to the potential woes of a banking system in which risk is poorly understood. Total debts of township and village governments alone may amount to well over 1 trillion yuan (\$125 billion), or more than 5% of GDP.

When land is seized, peasants are compensated for its agricultural value, which according to some Chinese scholars averages about one-tenth of its market value. Village administrations take a cut, so the amount received by the peasants is often far less. By contrast, in the cities the privatisation of housing since the late 1990s has created a middle class that is using its property as collateral to borrow. Trading property has become a big source of urban wealth. Of China's 50 richest people, about half owe their fortunes in large part to property deals, according to Rupert Hoogewerf, the author of China's first rich list.

Scattered and ill-organised rural protests are unlikely to turn into a serious threat to the party. China's political future depends largely on stability in the cities. Mao's armies of landless and disgruntled peasants would be hard to recreate in today's more effectively controlled China. But the protests are a serious embarrassment to the current leadership, and they are likely to get worse as the cities expand relentlessly.

Some Chinese scholars suggest curbing the powers of rural governments to appropriate land, and giving individual peasants the right to trade it, mortgage it or keep it indefinitely. Secure rights would encourage farmers to invest more. This would help make land more productive. Giving farmers the right to negotiate the sale of their land to developers directly would greatly improve their chances of realising the market value of their holdings. And restricting land seizures could help push up the price of land on the periphery of urban areas and encourage a more rational use of existing urban land. Such measures could also help ease the government's worries about the loss of food security arising from the rapid encroachment on rural land.

There is huge resistance to change. One reason is that allowing the "marketisation" of rural land would be seen as a direct assault on party ideology. But to a party that cares more about its survival than it does about communist principles, a more important consideration is the risk of instability. It fears that creating a free market in rural land would prompt peasants to sell their holdings to pay their debts, sending an avalanche of landless farmers to cities that have no social-security infrastructure to deal with them.

The party's fears are overblown. Given the parlous state of urban China's social-security system, peasants would continue to regard land as a vital safety net, to be relinquished only in extreme circumstances. True, the system that kept rural and urban China rigidly separated is gradually being dismantled to allow cheap rural labour into the urban workforce; but migrants from the countryside generally get the most menial jobs, miss out on subsidised health care and are often denied access to oversubscribed urban schools. And if they cannot find a job, they will find the cities prohibitively expensive.

## Reform by stealth

To make rural land reform work, fiscal transfers from the centre to the provinces would also have to be made fairer, and that too would require considerable political will because richer provinces would be reluctant to lose their advantages. However, the government is inching in the right direction. In 1998 it ordered written land-use contracts to be issued to peasants (though this rule is widely ignored). A law introduced in 2003 restricted the right of collectives to reassign land within villages and provided a legal basis for transfers of land between peasants for farming.

Reform by stealth has been a hallmark of much of China's economic transformation in the past quarter-century. The leasing of land to households in the early 1980s began as a grassroots initiative that gradually gained official support and was already being widely practised by the time it was given the party's formal approval. Late last year in Guangdong province, one of China's most affluent regions (and also the scene of some of the most violent peasant protests reported recently), the authorities began allowing villages to trade land that had already been converted to industrial use. This step was hailed by one state-controlled newspaper as the start of a "new land revolution".

But the "new socialist countryside" now being championed by China's leaders is unlikely to bring a sweeping change in the way rural land is organised. Chinese officials have been inspired by South Korea's "new village movement" launched in the 1970s, when that country was similarly worried about rapid urbanisation and the wealth gap between urban and rural areas. South Korea's government spent heavily on rural infrastructure and on providing farmers with building materials. But the Chinese have made little mention of South Korea's earlier land reform in 1949 which gave secure marketable rights to former tenants, and which proved to be a key factor in South Korea's successful transition from agricultural economy to industrial powerhouse. Still less have they dwelt on Taiwan's similar and highly acclaimed land reform of the early 1950s.

Incremental steps over the next few years towards the creation of a rural land market and a reduction in local governments' share of health-care and education costs would give farmers a far better chance to prosper, whether on their land or in the cities. That would be good news for China's economy, which badly needs a new engine of consumer-led growth.

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## A piece of the action

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### How one rural community hit it lucky

THE village of He Hua in Wenzhou municipality, about 365km (225 miles) south of Shanghai, is a typically bizarre product of China's bipolar economy with its rigid distinction between urban and rural. A stranger looking at its streets lined with shops, restaurants, office blocks and apartment buildings would have no idea that it is a village at all. It looks just like any other urban area of Wenzhou, one of China's most prosperous cities.

The rapid outward expansion of Chinese cities in recent years has swallowed many villages like He Hua, which 20 years ago was an expanse of paddy fields. Sometimes the land is appropriated by the government and sold on to developers, with some of the money being used to rehouse the villagers who are reclassified as urban residents. But often villages have remained villages, looking urban but governed by different economic rules. He Hua is one of those.

The He Hua village office, down a shabby alleyway next to a luxury housing development, is now the headquarters of a property company that is making good use of the village's virtual existence within Wenzhou's urban sprawl. These "villages within cities", as they are called, can take advantage of urban housing demand to rake in fortunes with their remaining plots of collectively owned land. And if the villagers are lucky, as they are in He Hua, they will get a generous share of the money.

He Hua's village committee is just about to redesignate itself as the He Hua Village Economic Shareholding Co-operative, a process that has taken four years. The elected village chief has become its general manager. The village's former Communist Party leader is now chairman of the board. All this has taken a long time to organise because assets had to be valued and, most contentiously, shareholders identified. Only villagers can be shareholders, but it was not easy to decide how to deal with villagers who had moved elsewhere and wanted to come back to enjoy the spoils.

Outside the village office, with its new Shareholding Co-operative nameplate, are the fruits of all this toil: sheets of paper on a bulletin board listing the 363 shareholders. They make up less than a quarter of the area's current population. Mao, who famously said that women hold up half the sky, would not be happy with the list. He Hua has decided that when it comes to share allocations, women are worth only six-tenths of men. Jin Zhengzhong, the general manager, explains that this is based on traditional rural reckoning which values a woman's labour at half that of a man's. But even this is progress of sorts: before the new co-operative was established, profits were handed out only to male family heads, to divide up as they wished.

Turning villagers into shareholders is a big improvement on the hazy "collective" ownership notion prevailing in most of rural China. But although He Hua's villagers will be rich by local standards (an adult male shareholder can expect a dividend of \$5,000 a year, which amounts to a comfortable urban income), they have not found the answer to China's land problem. Their shares will be diluted if their numbers grow; they cannot be sold except to other villagers; and the government could still take the

land away.

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## Keep growing

Mar 23rd 2006

From The Economist print edition



**We've come to help with the pension crisis**

### Easier said than done

SHOULD China's growth falter, the country's ability to maintain social and political stability would be in great doubt. A prolonged slump in property prices would confront homeowners with their first taste of negative equity and banks with a millstone of bad loans. Urban unemployment would rise perilously. Bottled-up grievances over corruption and poor governance could set off open unrest with support from an urban middle class no longer so enamoured of the status quo.

But how likely is that? For a quarter-century, China has officially enjoyed average annual GDP growth rates of more than 9%. Even allowing for occasional over- and underestimates, average rates may have been higher than those achieved by any other Asian country during a similar period of rapid development. China suffered sharp slowdowns in the early 1990s and again later that decade, but quickly recovered. Those who predicted a hard landing for the country's economy two years ago as it applied the brakes have been proved wrong, at least so far. Growth in 2006, barring some calamity, looks likely to be only slightly lower than last year's 9.9%. Few expect a protracted slowdown in the remaining years of this decade.

However, big problems need to be tackled if China is to maintain rapid growth through the next decade. "We've pretty well done the easy reforms. What's ahead are the difficult ones," says Gao Shangquan, a senior government adviser. These include a state-owned banking system burdened with non-performing loans, a state sector which despite considerable trimming remains massive and inefficient, and a social-security system that does not live up to the name. If China fails to deal with these, it could find itself going through the same experience as Japan in the 1990s, when bad loans led to a credit crunch

and a long economic slowdown.

China's economy has a number of strengths beyond its rapid growth. Government finances appear reasonably healthy, with national revenue growth averaging 18% a year since 1994, a deficit of 1.6% of GDP and public debt of less than a quarter of GDP (see chart 4). This gives the government some room to pump up the economy if need be. China has one of the world's highest saving rates, at some 40% of GDP, and foreign-exchange reserves of \$845 billion, second only to Japan's.

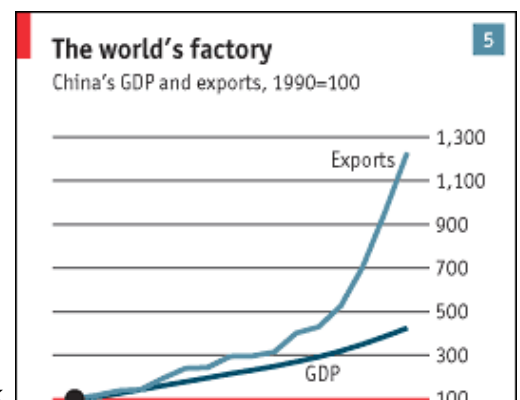
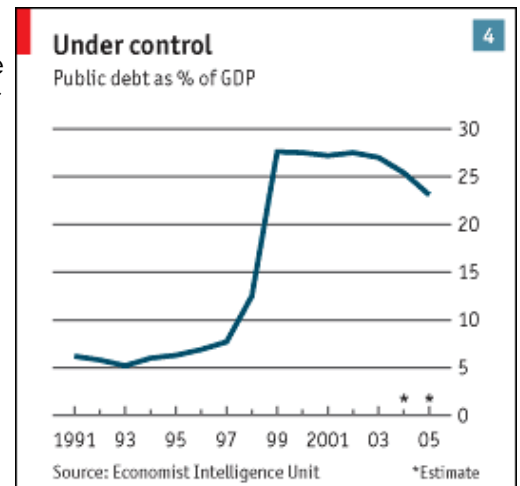
The country is making some headway against its problems, partly by design and partly thanks to rapid growth. It has laid off 20m-30m workers from state-owned enterprises (SOEs) in a huge wave of closures, mergers and privatisations that has halved their number since the mid-1990s. Although this has pushed up unemployment, many workers have been absorbed into the rapidly expanding non-state sector. SOEs now account for less than one-third of GDP, against almost all of it in the early 1980s. But that still leaves nearly 140,000 of them, employing 40m people. The state sector still accounts for more than half of all industrial assets, only ten percentage points down on 1998. More than one-third of these SOEs are making no return on their investment and need to be closed down or sold off.

On the brighter side, profits in the 169 large centrally controlled enterprises grew by nearly 28% to \$78 billion last year. In bigger SOEs, efforts to remove the state from day-to-day control, introduce western commercial practices and strengthen the role of shareholders are making progress. The creation in 2003 of a new body to manage non-financial state assets, the State-Owned Assets Supervision and Administration Committee, has put a buffer between government and enterprise management and clarified rules for restructuring. A new bankruptcy law could be adopted this year, though it remains to be seen whether this is good for banks, whose claims come low in the pecking order under current legislation. The government's priority has been to pay off workers.

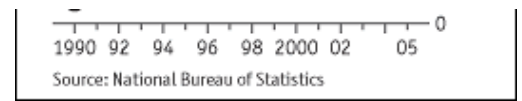
With half of all bank loans going to SOEs, the problems of the two sectors are closely interlinked. But even in banking, which many regard as the weakest link in China's economy, there has been some progress. There is less talk now about a possible banking crisis than there was at the beginning of the decade. Non-performing-loan ratios remain high, perhaps twice as high as official figures put them in the "big four" state-owned commercial banks. But following the transfer of 1.4 trillion yuan of non-performing loans to asset-management companies in 1999, a series of capital injections into the banks since the late 1990s and a tightening of credit management, three of the big four—Bank of China, China Construction Bank and the Industrial and Commercial Bank of China (ICBC)—are looking somewhat healthier. They have introduced stricter monitoring of non-performing loans and trimmed their staffs by a total of nearly 250,000 people. UBS, an investment bank, reckons that the non-performing-loan stock of the big four and other Chinese banks is now only around 30%, half of its peak level in the late 1990s (though that would still make China's one of the worst banking systems in Asia).

These moves have helped prepare the banks for listings overseas, which are intended to sharpen their operation as commercial institutions. China Construction Bank launched its initial public offering in Hong Kong in October 2005. Bank of China and ICBC, which has the biggest assets of the commercial banks, say they are getting ready to follow suit this year and expect to raise \$5 billion-10 billion apiece.

In advance of their listings, the banks have also been selling strategic stakes to foreign financial institutions. But foreign ownership of banks is capped at 25%, and it is not clear how much say in management these investors will be given. Wu Xiaoling, a deputy governor of the central bank, the People's Bank



of China, says the government has no plans to surrender control of any of the big four within the next five years. The party still regards state ownership of the banks as a vital bulwark against financial instability. It knows that this often leads to unproductive investments. But it also shores up public confidence in the banking system, which is essential for maintaining the flow of savings and foreign investment.



Chinese banking officials admit there is a need for foreign expertise, but fear that encouraging the development of privately controlled Chinese banks would exacerbate financial risk. As Ms Wu explains, private investors in China tend to regard such banks as vehicles for raising money for their own business interests, and private business interests can be very murky. In 2004, the government took over D'Long, a private investment firm in Shanghai that was billions of dollars in debt. It was a signal that the state will still intervene if it thinks that a company's collapse might threaten social or economic stability.

## Too much saving is bad for you

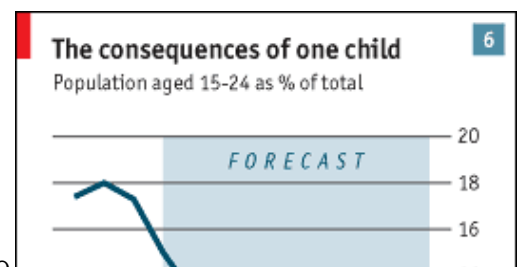
With its huge foreign-exchange reserves, strong revenues and low deficit, China still has the wherewithal to prop up its banks. The saving rate is likely to remain high, given concerns about pensions and other social-security provisions. And there are few other places for savers to put their money: China's SOE-heavy stockmarkets have been among the world's worst performers in the past five years, and controls on capital outflows remain largely effective. The opening up of China's banking system to foreign competition at the end of this year—a commitment made by China when it joined the WTO—will have little effect in the short run because Chinese regulations make the cost of setting up large branch networks prohibitively high.

But if China's growth is to be led by consumption rather than by investment and exports, as most analysts agree it needs to be in order to avoid boom-bust cycles and growing friction with trading partners, the country will need to get used to a lower saving rate. And the banks are still in poor shape. A large share of lending from the boom of 2001-04 could turn into bad debt. Although official figures for non-performing loans look encouraging, they mostly rely on the accounting trick of moving such loans into asset-management companies. China's property market, though sustained by strong demand for new urban housing, could turn into a bubble.

Boosting private consumption could be difficult in a country with a GDP per person of only \$1,700, especially given the absence of a comprehensive social-security system. The government needs to boost its own consumption first. This means spending more on health care and education, and expanding the social-security network in rural as well as urban areas. Changing demographics make this all the more important. Over the next 10-15 years, the rapid ageing of the population will increasingly make itself felt. As the labour force begins to shrink, the current pay-as-you-go pension system will become unsustainable. Life expectancy in China is high by the standards of developing countries and is likely to go on rising.

Goldman Sachs, an investment bank, reckons that China's "demographic bonus" of a large working-age population with a small number of dependants (helped by the one-child-per-couple policy introduced in the late 1970s) will shortly run out as the number of young workers starts declining (see chart 6). The country's dependency ratio will begin to rise by 2010, whereas India, on current trends, will not reach that point until 2040.

The government has been trying to develop a new pension system, including elements of both pay-as-you-go and funding, whereby it invests on behalf of workers and then pays them pensions from their individual accounts. But it will be many years before China has a sufficiently mature bond and equity market to make this workable. Yields on domestic bonds are low, and the 15-year-old stock exchanges are still hardly worthy of the name. The cost of establishing the new funds at the same time as meeting current pension obligations will be very heavy. It could be



reduced by bringing more workers into the scheme (at present only one-third of urban employees are covered, and rural residents not at all), but it would be difficult to persuade them to take part in such a seemingly risky venture. With no expansion of pension coverage, liabilities for future pension payments could amount to 70% of current GDP.

But Goldman Sachs argues that the effect of China's growing dependency ratio will be mitigated by the rising productivity of an increasingly well-educated workforce. It could also be counteracted by productivity gains as more people migrate from rural to urban areas if China can sort out its rural land mess. Officials are considering an easing of the one-child policy, which could help as well.

President Hu and Mr Wen have signalled a greater willingness to spend on public services. They have repeatedly stressed that they want to steer China away from an environment-destroying blind pursuit of economic growth, devote more resources to health care and education and reduce inequalities. Their curious choice of slogan is, "Put people at the centre"—a phrase that in China is known mainly as the Chinese rendition of Nokia's trademark slogan "connecting people".

However, the new five-year economic plan adopted in March gives little hint of any fundamental shift in spending priorities. It modestly calls for a mere doubling of GDP per person between 2000 and 2010, which implies that the current GDP growth rate might slow down considerably. The plan modestly forecasts an average annual growth rate of 7.5% for the next few years. But in their own five-year plans many local governments are predicting double-digit growth. High growth, the party believes, is still vital to its grip on power. And for the foreseeable future this will mainly come from the same sources as it does now: investment and exports.

In this, China is following the development pattern of several other Asian economies before it. But along with economic growth will come rising expectations—on the part of Chinese citizens for a greater say in decision-making, and on the part of the rest of the world for a China wedded not just to capitalism but to the principles of open government, private initiative, sound corporate governance and legal impartiality. Elsewhere in Asia, rapid growth has often gone hand in hand with political change. China's leaders know that both the world and their own people are watching closely.



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## Good things in tiny packages

Mar 23rd 2006

From The Economist print edition



### A little democracy has to go a very long way

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JIN LIANGMING, the party chief of the booming Xinhe township on the coast of Zhejiang province, has something unusual to show a visiting foreign journalist: a detailed (by Chinese standards) budget report for his government. Many Chinese officials would worry about losing their job or even going to jail for this, but when your correspondent asks for a breakdown of its implementation, Mr Jin gets detailed monthly statements printed out.

Government budgets in China are usually treated as secrets, except for vague headline figures issued for public consumption. The annual state budget is a flimsy pamphlet that gives only a broad outline of spending priorities and commitments and says nothing about budgets for individual ministries. Deputies in the Communist-Party-controlled legislature pass it without amendment (the latest went through on March 14th).

It is a sad reflection on China's progress towards more open government that the bits of paper supplied by Mr Jin seem so exciting. Whereas economically China has surged ahead in the past few years, politically it remains almost as secretive, just as risk-averse, nearly as dictatorial and every bit as determined to crush any organised dissent as it was at the turn of the decade.

Gone are the days when foreign observers celebrated China's efforts to promote a semblance of village democracy in the 1990s. Many thought this might be the start of a gradual rise of democracy from the grassroots. But although a handful of townships (the first tier of government—village administrations formally do not count) have tried to introduce similar reforms, the central leadership has done little to encourage this. Last September the prime minister, Mr Wen, hinted that townships could have direct elections within a few years, but his statement was loaded with ambiguity.

Even for a government reluctant to reform, making the budgetary process more open to the public looks promising. Unlike direct elections at the township or higher levels, making government budgets more transparent would not require any constitutional change. It would be in keeping with the principle of open government to which China's new leaders have paid some lip service. It could help reduce some of the bureaucracy's prodigious waste. And making government budgets more open would go to the heart

of the democratic process, giving the public a say in how public resources are deployed.

Mr Jin is not quite alone in his experiment with openness among the paddyfields, clothing factories and scrapyards of Xinhe (population 120,000). The province of Guangdong (population 83m), like Zhejiang one of China's wealthiest, has inched along the same path. In 2004 it handed deputies to the provincial legislature a budget report of over 500 pages. But it was marked "secret", and they had only two days to study it before voting on it and handing it back.

Xinhe's budget reform, launched last year, is being promoted as a model by reform-minded Beijing academics and encouraged by moderately reformist party leaders in Zhejiang. But not even its neighbours are yet following suit, let alone the 43,000-odd other townships in China. "There are many leaders better than us," laments Mr Jin. "But the problem is they don't have the courage." Even his new-look budget report does not tell all. It provides no clues, for instance, to the complex web of extra-budgetary flows managed by every tier of government, including their dealings through government-owned companies. But it does usefully—and unusually—admit that the township is in debt to the tune of more than \$6m.

### While the world is watching

The budget experiment is unlikely to take off in a big way. Serious political reform is not currently on the party's agenda, and is unlikely to get any attention until after the Olympic Games, if then. Many observers see little hope of any significant movement until after 2012, when a new generation of leaders is due to take over. For now, President Hu and Mr Wen appear far more concerned with maintaining stability than with the long-term challenge of moving to a more pluralist system.

China's leaders are worried that international attention focused on China in the run-up to the games could encourage disaffected citizens to air their grievances. The Tiananmen Square protests in 1989 gathered steam when hundreds of foreign journalists poured into Beijing to report on the first summit meeting between China and the Soviet Union since the end of the cold war—and found themselves diverted by swelling crowds of demonstrators. The protesters calculated that the authorities, anxious not to tarnish China's image in front of the Soviet president, Mikhail Gorbachev, as well as the world's media, would leave them alone. They were partly right: China waited until the day after Mr Gorbachev left before declaring martial law. The media stayed on.

AP



**Hu and Wen have their hands full**

The Olympics in 2008 are likely to attract more than 20,000 foreign media representatives, who will be accredited not by China but by the International Olympic Committee. It will be by far the biggest media event in the communist nation's history, testing its ability to accept critical scrutiny to the limit. China's strategy, it seems, will be to try to ensure that nothing untoward happens in the run-up to the event. It

is keenly aware of unrest in other Olympic cities ahead of the games. Both Mexico City in 1968 and Seoul in 1988 saw large anti-government protests. Mexico's ended with a bloody crackdown.

But unlike the Mexican authorities, the Chinese ones appear to have mobilised broad support for the games. And unlike in Seoul, where public sentiment was still inflamed by a massacre of protesters in Kwangju eight years earlier, there is no particular rallying cause in China today. The 1989 killings in Beijing have become a distant memory. Although many Chinese citizens have grievances against officialdom, these would be hard to galvanise into an organised protest movement.

Opinion surveys suggest that despite frequent public protests in the countryside as well as in the cities, the central government still enjoys a considerable degree of support. Government becomes increasingly unpopular further down the hierarchy. Thus angry peasants direct their resentment at rural authorities rather than at the central leadership or the Communist Party. According to Tony Saich of Harvard University, a survey spanning the past three years shows that support for the central government has remained "extremely high". This, he says, fits with a traditional Chinese view of government that "there's a good emperor there if only we can get through to him." Thousands of people go to Beijing every year to ask the central government to redress local injustices. Their inevitable disappointment does not appear to dim their belief that it is local government, rather than the top leadership or the system itself, that is the problem.

But the authorities are still jittery. President Hu's assessment of threats to the party's rule appears to be much the same as that of his predecessors, despite the rapid rise in incomes in recent years. A resolution at the party meeting in 2004 at which Mr Hu consolidated his power after a lengthy co-regnum with his predecessor, Jiang Zemin, said there had been "no change in the strategic conspiracy of hostile forces to westernise and cause China to disintegrate". The leadership has been particularly rattled by the "colour revolutions" against authoritarian governments in Georgia in 2003, Ukraine in 2004 and Kyrgyzstan in 2005.

The past few months have seen one of the most wide-ranging campaigns in recent years to stifle public criticism of the government. Outspoken newspapers have been closed or their editors sacked, pressure on non-governmental organisations has been stepped up and dissidents who have posted their views on the internet have been jailed. Initial expectations that Mr Hu might push political reform further than his cautious predecessor have all but evaporated. Mr Hu has also presided over one of the most intensive indoctrination campaigns among party officials in recent years.

In the run-up to the Olympics, even the glimmer of democracy only just tolerated at the grassroots level is making the government nervous. That may explain why Beijing's authorities have decided to hold the next round of elections for district-level legislatures in the city at the end of this year rather than in 2007, as the rules would also have allowed. The previous round of elections in 2003 saw the first political stirrings of the city's new middle class, with several independent candidates joining the campaign (and, unusually, being left to get on with it). Many of these were relatively prosperous home owners and lawyers with an interest in property rights. It seems that the government does not want such people campaigning too close to the Olympics.

Optimists argue that the leadership's conservatism is tactical and does not necessarily signify a rigid opposition to reform. New leaderships in China have a tendency to crack down as they consolidate their power. That is what Deng Xiaoping did in 1979 when he shut down Beijing's Democracy Wall and jailed many dissidents. Jiang Zemin relentlessly pursued Tiananmen Square activists after he (nominally) took over in 1989.

President Hu, for his part, has displayed a curious streak of respect for liberal leaders of the past. He allowed hundreds of people, including dissidents, to join a funeral service for a deposed party chief, Zhao Ziyang, in January 2005. And in November he organised a public commemoration of the 90th anniversary of the birth of the late Hu Yaobang, who was also ousted because of his reformist beliefs. But in the build-up to the party's 17th congress in late 2007, Mr Hu might be eager to display his toughness.

Such congresses are mere rubber-stamp events held every five years to confirm party policy and name new leaders. The important part is the intense and secretive wrangling that precedes them. Mr Hu is

limited to two five-year terms as president, and convention requires that he also step down as party chief in 2012, so it will be a big opportunity for him to begin installing his own successors. Likely front-runners for top positions include several provincial party bosses: Li Keqiang of Liaoning province in the north-east, Li Yuanchao of coastal Jiangsu province and Xi Jinping of Zhejiang, all of whom are as inscrutable as is Mr Hu.

If Mr Hu has anything interesting to say about how the party should change, the congress would be the forum at which to make it known. In the coming months, debate within the party over the way the congress should tackle such issues as political reform and better governance is likely to intensify. The approach of the Olympics will fuel that debate. A survey by a senior Chinese academic conducted about two years ago among nearly 600 provincial and lower-level party officials in one (unnamed) province found that 85% of the respondents wanted to speed up political reform and more than 60% were dissatisfied or very dissatisfied with the level of democracy in China.

One area of disagreement within the party is over the way that the hoped-for "harmonious society" should be brought about. When China acceded to the WTO in 2001, there was little public opposition to the principle of globalisation. But the past few years have seen an increasingly bitter divide among Chinese intellectuals (and party officials) over the merits of the Dickensian capitalism that China appears to have embraced. Growing inequalities of wealth and access to public services have prompted strident criticism of economic "neo-liberalism".

Champions of a more caring, worker-friendly kind of capitalism are now dubbed the "new left". One of their flagbearers, Wang Hui, the editor of a widely read and outspoken literary journal, *Dushu*, says workers should be allowed to have independent trade unions rather than impotent party-controlled ones. He fears the way SOEs are being privatised might create an oligarchy of a wealthy elite controlling the country's resources, as in Russia. Last year 105 new-left intellectuals submitted a letter to the leadership to protest against a government directive allowing domestic private investment in the state's hitherto jealously guarded preserves such as power, railways and telecommunications.

The leadership, with its populist bent, has shown a degree of sympathy. Partly in response to such criticisms (as well as concerns about worker unrest), it has tightened control over management buy-outs of state-owned enterprises. And it has recently put a new property law on ice. Supporters say the law is needed to reassure the private sector and the middle classes. "New left" critics say it fails to protect the "sanctity" of state property.

## Turning green

Environmentalists will pitch into this debate too, encouraged by another of Mr Hu's slogans, calling for "scientific development". China has pledged massive efforts to clean up Beijing's appalling pollution in time for the Olympics. Its best bet will be to order the temporary closure of polluting industries across a wide swathe of northern China in the run-up to the games, as well as introducing draconian traffic-control measures in Beijing. But some environmentalists are using the party's avowed interest in greenness to push for greater outside supervision of government activity in this area.

Even some officials at the State Environmental Protection Administration see the environmental cause as a low-risk way of encouraging greater public involvement in policymaking. "The government has realised that without environmental NGOs to help them and tell them promptly what is happening on the ground, there could be sudden social turbulence," says Dai Qing, an environmental activist in Beijing. The government's tolerance has its limits, however: Ms Dai is under police surveillance.

Mr Hu doubtless wants to stop any such pressures from developing into a concerted political challenge. A year after the Olympics comes the 20th anniversary of the Tiananmen Square protests. The tumult and bloodshed of 1989 may no longer inspire passion among ordinary Beijing residents, but within the party Tiananmen is still a sore point. Any fundamental political reform would have to begin with a reassessment of it, and neither Mr Hu nor any of his colleagues shows any sign of being ready for that.

Some liberals within the party worry privately that this reluctance to loosen its grip could make it increasingly vulnerable to unexpected shock—a sudden economic slowdown, a huge natural disaster or

a health crisis such as bird flu. Such events could trigger both private and public questioning of the party's ability to rule that might shatter its unity and cause its rapid collapse. To avert such a fate, the party is turning to a time-honoured technique in times of domestic uncertainty: tapping the wellsprings of nationalism.

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## Pride and prejudice

Mar 23rd 2006

From The Economist print edition

**If in doubt about your place in the world, fall back on nationalism**

AP



Licensed to bash Japan

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CHINA'S leaders bridle at the suggestion that the country's growth will be anything other than benign, or that its rise will challenge the world's status quo. But history could prove them wrong. The rapid rise of great powers has a habit of causing bloody confrontation. And when such a power harbours resentment at its past humiliation by others, covets long-lost territories and secretly and rapidly upgrades its military potential, it would seem reasonable for observers to worry.

To Chinese officials, the Olympic Games in 2008 will symbolise the country's re-emergence on the world stage after more than 150 years of humiliation and isolation by western powers. Many Chinese saw the narrow failure of their bid to host the games in 2000 as the result of malicious western attempts to keep their country in check. When its second attempt succeeded by a comfortable margin, it was seen as a belated recognition by the West that China should be treated as a respectable country. This would be its chance to show itself off as a proud, strong nation.

Party leaders hope that national pride will help the country to remain stable and united amid turbulent social and economic change. By playing to the public's patriotic sentiments, the party also hopes to strengthen its claim to legitimacy. This has been an important motive behind China's recent push to become a space power, with the launch of two manned orbital craft in 2003 and 2005. It is possible that later this year China will launch an unmanned spacecraft to orbit the moon, a step towards an eventual moon landing by a Chinese astronaut.

This strategy of encouraging national pride also carries some risks for the party, particularly if the public

feels that the government is not being nationalist enough. It means that whatever action China's leaders take on sensitive issues such as Japan, Taiwan and America will have "very broad implications for domestic politics", as Christopher Hughes of the London School of Economics argues in a book just published. The dangers this strategy could pose for international security are even more apparent.

Ironically, the past few years of China's rapid economic rise and integration with the outside world have also brought a rising number of angry public protests over nationalist issues. In the two biggest and most unruly incidents—demonstrations against America and Britain in 1999 following the bombing of the Chinese embassy in Belgrade, and anti-Japanese protests in April last year—the government at first appeared to be condoning if not encouraging the outbursts. Those who argued that giving China the Olympics would help tame such nationalism have been proved wrong.

## Nationalist tit for tat

Untamed, that Chinese nationalism risks starting a vicious cycle as nationalists elsewhere respond. The Japanese grumble about Chinese criticism of their wartime record which they regard as politically motivated. Unwilling to be seen as capitulating to China, Japan's prime minister, Junichiro Koizumi, continues his controversial visits to the Yasukuni Shrine where Japan's wartime history is celebrated. In Taiwan, a new sense of identity is emerging that emphasises the island's cultural and historical distinctness from China. The more China attacks this trend, the more Taiwanese nationalists shout back.

The growth of nationalist sentiment in China has coincided with a double-digit increase in China's military spending every year since the mid-1990s. An uneasy Japan has been strengthening its security ties with America. It has also been manoeuvring—with some success—to keep China from turning the Association for South-East Asian Nations into the nucleus of a China-dominated grouping of East Asian countries. In north-east Asia, the two countries have territorial disputes that inflame nationalist passions on both sides.

Fortunately both China and Japan realise that they cannot afford to let these quarrels escalate. Economic interdependence between the two countries has grown by leaps and bounds in recent years. China (with Hong Kong) has helped to lift Japan out of stagnation, becoming its biggest trading partner in 2004. Last year, by Japan's reckoning, the total volume of trade between the two countries was nearly \$190 billion. Japan accounted for 11% of foreign direct investment in China in the first nine months of last year, making it the biggest investor after Hong Kong. In October last year, Mr Koizumi appointed an official widely seen as "pro-China", Toshihiro Nikai, as his trade minister.

But China has been refusing to talk to Mr Koizumi since his last visit to the Yasukuni shrine in October. And even when China is talking, the frosty state of relations makes it difficult for the two countries to establish mechanisms for dealing with sudden crises in their relationship. For several hours during last year's anti-Japanese demonstrations in Beijing, nervous Japanese diplomats were unable to reach China's foreign ministry by phone.

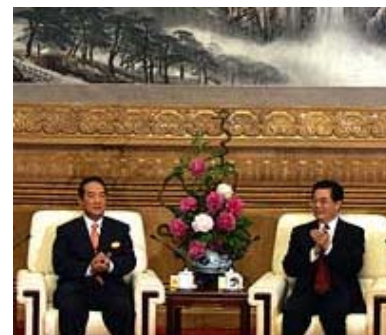
If a Japanese vessel were to collide with a Chinese one in a disputed area of the East China Sea, causing Chinese casualties, it is easy to imagine an outbreak of violent protests in China that could rapidly escalate. Such risks could grow as Chinese navy vessels become more active in the area. A Chinese submarine was spotted near Okinawa in 2004, and last year China briefly deployed warships near its controversial gas-drilling rigs in the East China Sea. Some Japanese diplomats fret that China's Communist Party may not have full control over the military.

So far, however, both China and Japan, while verbally pandering to nationalists in their respective countries, have tried to avoid going beyond diplomatic skirmishing. Having let last April's protests run for a few days, the Chinese authorities decided to rein them in, apparently concerned about the risk of a serious breakdown in relations with Japan. In recent weeks China's criticism of Japan has become more muted. Perhaps the Chinese are waiting to see what happens when Mr Koizumi steps down in September.

AP



One problem for China is that its most active nationalists are drawn from the very middle class upon whose support the party depends. Peter Gries of the University of Colorado says that many of those who took part in last year's protests were "savvy urban yuppies" rather than the losers from economic reform. Mr Gries describes them as "computer-literate cyber-nationalists", well educated and exposed to world politics. The rapid spread of internet technology in China in recent years has provided new forums for nationalists to air their views. Although China's internet censors closely monitor debate on internal political issues, they give diatribes against Japan a much freer rein.



**A warm welcome from Hu (right) to Soong**

China may feel that it can afford to give the public leeway to rail against Japan because military conflict with that country is highly unlikely. The two other big preoccupations of Chinese nationalists—Taiwan and its military backer, America—are in a different category, and the government has tried much harder to prevent public sentiment from getting out of hand.

### Let's be pragmatic

Indeed, in the past few months China's handling of Taiwan has shifted direction to become remarkably pragmatic. China has moved swiftly to stem a torrent of protest from Taiwan and the West against a new law adopted in March 2005 that authorised the use of force against the island should it ever try to secede from China. President Hu hosted unprecedented visits by Taiwan's opposition leaders which did much to reassure the Taiwanese public. James Soong, leader of the opposition People First Party, says that during his stay Chinese leaders officially accepted, "for the first time in history", that Taiwan and the mainland were "equal entities".

Kenneth Lieberthal, a former National Security Council adviser, says President Hu has apparently decided that unification with Taiwan is simply not feasible during his term of office. Although China continues to concentrate its military modernisation efforts on improving its ability to fight Taiwan and American forces that might try to protect the island, Taiwan has become much less of a sore point between China and America than it was.

Events in Taiwan in the next couple of years could make China and America more jittery again. In December next year Taiwan is due to hold elections for its legislature and in March 2008 for the presidency. Both China and America are clearly worried that President Chen will use his remaining two years in office to push for confirmation of Taiwan's independent identity. With his popularity at an all-time low, partly because of corruption cases within his party, Mr Chen may well feel inclined to use Taiwanese nationalism to shore up his popularity at home. In the past, Mr Chen has successfully exploited this sentiment to undermine his opponents, who favour closer ties, though not reunification, with the mainland.

Mr Chen has already unsettled the Chinese and Americans this year by scrapping the National Unification Council, a body that existed in name only to help Taiwan maintain the fiction that it has not abandoned the idea of rejoining China. He has also revived talk of organising a referendum, in 2007, on a new constitution for the island. China objects strenuously to this as a display of sovereign power that Taiwan in fact lacks. America has tartly reminded Mr Chen of his promises not to upset the status quo. Taiwan officials say it is China that should be blamed for having passed the anti-secession law.

The pragmatism of China's leaders could also face new challenges in Hong Kong, which in March next year will hold elections for the post of chief executive and in 2008 for the legislature. China has ruled out universal suffrage for either, and is resisting demands for a timetable to be set for introducing it.

But China has reason to feel relatively confident. In Taiwan, President Chen would need three-quarters of the members of parliament to approve any constitutional change. Given the opposition's domination of the parliament, that would make it extremely difficult for him to get enough votes for anything that would seriously anger China. And China is happy with indications that Ma Ying-jeou, the charismatic mayor of Taipei and chairman of the opposition Kuomintang party, is the likely front-runner to succeed

President Chen. Mr Ma, though not keen on reunification as long as China remains a one-party dictatorship, is no advocate of independence. In Hong Kong, meanwhile, pro-democracy activists have shown no interest in street fights with the authorities.

The relationship that will dominate all others is that between China and America. In the run-up to America's presidential elections in 2008, China's rise is likely to become ever more contentious. America's trade deficit with China, which at \$200 billion in 2005 was its biggest with any country, will probably remain very large, particularly in the likely event of China resisting American demands for a substantial revaluation of its currency. Workers in America's industrial mid-west already blame China for the loss of manufacturing jobs. And news that China last year became a net exporter of motor vehicles for the first time might cause further unease.

David Lampton, an American scholar, has argued that the past few years have seen a "marked paradigm shift" in American thinking about China that "threatens to substitute one flawed framework (a "weak China") with another (a "China on steroids"). This was evident in America's horror at last year's bid by China National Offshore Oil Corporation (CNOOC), a state-owned company, for Unocal, a California-based oil and gas explorer. It would have been the biggest takeover of a foreign company by a Chinese firm, but CNOOC was forced to withdraw by wildly exaggerated fears in America of a Chinese stranglehold on vital resources.

Americans have been watching with disquiet as China has cosied up to pariah governments in Venezuela, Zimbabwe, Sudan and Iran to feed its growing hunger for resources. In Iran in particular, China's efforts to keep its economy fuelled could put it in conflict with what America regards as a vital strategic interest: keeping the Arab world free of nuclear weapons. Over the past 13 years, China has moved from being a net exporter of oil to become the world's second-biggest importer, relying on foreign sources for 40% of its demand. So Iran, which supplies 11% of China's oil imports, might need special consideration.

But China's foot-dragging on Iran could be seen as evidence of the same kind of pragmatism that has dominated the country's relationship with America for most of the period since the end of the cold war. China has advocated persisting with diplomatic efforts. Yet in January, when Russia signalled its willingness to allow Iran's nuclear programme to be referred to the United Nations Security Council, China did not attempt to block the move. China is loth to interfere in other countries' affairs because it fears that others might use such a move to justify interfering in China's. It would therefore be remarkable if the country were to vote in favour of sanctions. But it would be no less remarkable if it were to veto sanctions on its own.

China's military build-up in the next few years will alarm the Americans, particularly as it becomes clear that its forces would be able to overwhelm Taiwan and inflict enormous losses on the Americans if they chose to intervene. But there are very good reasons why China would be highly unlikely to attack Taiwan, even if it had the capability to do so. Such an attack would devastate China's relationship with the West as well as with other Asian countries, and could cripple the economic growth that the party regards as so vital. The trouble is that planners in the Pentagon cannot afford to bet on it.

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## No time like the present

Mar 23rd 2006

From The Economist print edition

### If China wants to reform, it should act while the economy is booming



**A nation of 1.3 billion would-be consumers**

CHINA is an emerging power, but it still lacks the resources and the will to exert its influence globally. This year's budget calls for an increase of nearly 14% in the foreign aid it hands out, to \$1.1 billion. Last year China received its last shipment of food aid from the United Nations, and it is becoming increasingly active as an exporter of aid from South-East Asia to Africa. But at an international donors' conference in Beijing in January at which a total of \$1.9 billion was pledged to deal with bird flu, China offered a mere \$10m, against America's \$334m and Japan's \$155m. As Robert Sutter, a former American diplomat, puts it, China is not yet "ready for the prime time" with big contributions to international good causes.

In exerting "soft power", defined by Joseph Nye of Harvard University as "the ability to get what you want through attraction rather than coercion or payments", China hardly matters at all on the world stage. It is still struggling to define its development in a way that will keep foreigners happy. The term "peaceful rise" was fashionable for while, but then some officials felt that the word "rise" sounded too menacing. Now the term of choice is "peaceful development".

China tries to avoid portraying itself as an economic power, preferring to be seen as just another developing country. When it puts men in space, it does so to generate pride at home. Yet when foreign donors suggest that if it can afford such things it no longer needs so much outside help, China worries that the world is turning against it.

Although its economic rise does matter hugely, it is still right to see China as a normal developing country, more concerned with its own internal problems than with trying to influence faraway countries,

and profoundly insecure about the sustainability of the “miracle” that it has achieved. Jonathan Anderson of UBS argues that China's economic rise is really no miracle at all. Rather, it is a repeat (albeit concentrated on a single country) of a similar growth pattern already seen elsewhere in Asia. From 4% of world GDP today, Mr Anderson writes, China's share could well rise to 11% in 20 years' time. In 1965, Japan and other East Asian countries (excluding China) together accounted for 4% of global GDP. Twenty years later, their share had increased to 13%.

Curiously, it is often foreigners who point to China's strengths, whereas the Chinese media are full of downbeat reports. Unemployment, the growing gap between rich and poor, social unrest, crime, destruction of the environment, the health-care crisis, corruption: these are all subjects about which considerable gloom is permitted, as long as it does not involve blaming the political system itself or lead to predictions of China's collapse.

Added up, these problems could indeed be construed as serious threats to the party's survival. Not only is China's income distribution among the most unequal anywhere in the world—certainly worse than Russia's—but it has taken only a couple of decades to get to that point. Chinese people in their 40s and older began their careers at a time when China had one of the world's smallest income variations. China's situation may not be that much different from America's, but it is perceptions that count, as the United Nations Development Programme noted in a recent study. In America, less than 65% of the population think that income inequalities in their country are too wide. In China, the proportion is 95%.

Chinese officials sometimes say that income inequality in their country is close to, if not beyond, a “danger line” beyond which it poses a serious threat to social stability. Yet this overstates the problem, given that the measure is so skewed by the massive difference between urban and rural incomes. Resentment of inequality tends to be directed mainly at one's neighbours. And although inequalities within urban areas and in the countryside are big too, they can sometimes serve as a spur to greater effort—at least as long as the economy keeps growing.

As this survey has made clear, strong growth will not guarantee an easy ride. The National Development and Reform Commission, China's chief economic planning agency, has said that even with growth at 8% this year, China would be able to provide jobs for only 11m out of a total of 25m urban unemployed and new entrants to the urban workforce. That sounds worrying. But the general consensus is that growth will actually be closer to 9%, and many people find work in the grey economy and make ends meet. Unemployment is high in areas such as the rustbelt of the north-east, but not in cities of key political importance such as Beijing.

Even for many of those with legal jobs, life is far from easy. Last year the average monthly wage of migrants from the countryside—who provide the majority of manufacturing labour—was a mere 852 yuan (\$105) a month. They had no health-care or pension benefits, and certainly no independent trade unions. Even so, getting a job in a town or a factory remains a better prospect for most people than sitting idle and poor in the countryside.

Corruption, though rife and egregious, has not badly blemished the image of any top leaders, apart from Chen Xitong, a former Politburo member who was sentenced to 16 years in prison in 1998 for accepting bribes. This may be thanks in part to the extreme secrecy surrounding top leaders' lives. But there is anyway little public grumbling that Politburo members are using their power to amass fortunes in foreign bank accounts. What really worries ordinary citizens are health care and education for themselves and their families, but here a restructuring of the way the government allocates money for these, and a boost in spending (which China can afford) could help a lot.

## Try these

There are plenty of ways in which China could make itself fairer, freer and more open—and by doing so not only keep its people much happier but make its rise seem less unnerving to the West. A poll conducted by Ipsos-Reid last April indicated that 54% of Americans believed that the emergence of China as a superpower would be “a threat to world peace”. Nearly a third of Americans, it suggested, thought that China would “soon dominate the world”. More than 70% of Americans did not think that China would soon become a true democracy.

Some of the reforms needed could be achieved with little political change: giving farmers clear rights to their holdings; creating a social-security system that covers everyone; reducing the fiscal burden on low-level governments; and eliminating administrative barriers to internal migration. Some of these would be difficult or expensive, but they should be achievable without colossal disruption.

Some progress is being made. A revised compulsory-education law now being debated would for the first time specify central and provincial government's responsibilities for school funding. Officials say the aim is to provide free nine-year compulsory education in the countryside by the end of 2007.

Political reform is harder. For any progress to be made towards greater pluralism, sooner or later some organised opposition to the party would have to be allowed. That could cause massive social upheaval in a country undergoing such rapid change. But this is a risk that China will have to take. Waiting for its people to reach a certain level of education or income, which is often the official excuse for doing nothing, would not necessarily make the transition any easier when it eventually comes. It would, however, increase the risk of an explosion of discontent should the economy slow down. That could truly unnerve China's neighbours and the West. The best time for reform is while the economy is still booming.

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