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Discussion Paper

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On China's Internal Stability

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The most important political goal of the Chinese Communist Party (CCP) is to maintain its leadership and survival as long as possible. To do so, ‘economic development’ and ‘political stability and control’ while overcoming internal and external challenges are necessary conditions. So far, China has been able to develop its economy successfully. Throughout the reform era, China has endeavored to maintain peaceful international environment to help economic development, responding to external challenges in relatively low-profile. However, the most difficult task for the CCP appears to be how to deal with internal challenges. Roughly speaking, by 2020, internal stability issues will be the most challenging to Chinese leadership. The other two issues (economic development and external challenges) are relatively easy to manage. According to a Chinese source, Hu Jintao would wake up more frequently thinking of domestic problems than North Korean nuclear issues or Taiwan-strait issues. Hu Jintao’s nightmare comes from domestic issues rather than external challenges. This presentation is about the issue of internal stability of China.

1. China’s Successful Economic Development

One of the most endemic terminologies in the world must be “the rise of China.” Many prestigious organizations, think-tanks, and scholars predict that Chinese economy would be the top-ranked in the world by 2030. Some also seriously worries that China would challenge the US hegemony in international politics and military, destabilizing the world. As such, Chinese economic performance has been remarkable from late 1970s to 2006, with an average annual growth about 9%. Despite fuzzy statistics in debates among scholars, this record exceeds Japan’s and Korea’s “economic miracles” of past decades. In domestic politics, CCP has successfully maintained its dominance and political stability.

According to the grand strategy for economic development addressed in the 15th Party Congress in 1997, China targeted to reach US \$ 12,800 per capita by 2050, for the completion of modernization in the 100th anniversary of the establishment of People’s Republic of China. As a result, by 2050, China will be the top-ranked country in terms of economic size. Table 1 shows China’s three step (combination with small three steps) development strategy.

[Table 1] Economic Goals of China’s Grand Strategy (as of 1997)

	1980	1990	2000	2010	2020	2050
	1 st Step (一走步)		2 nd Step (二走步)	3 rd Step (三走步)		
				Petit 1st	Petit 2nd	Petit 3rd
GDP per Capita	100(×2)	200(×4)	800	1600(×2)	3200(×4)	12800

As of 2005, China’s economic growth has already outnumbered its targets. In 2005, Chinese GDP per capita reached about US \$ 1,700. A recent internal report of the Chinese Communist Party School illustrated that Chinese economic performance in 2006 was remarkably successful. GDP per capita was close to US \$ 2,000. China recorded 10.7% increase in GDP, maintaining double digit increases for four consecutive years; 24.0% increase in investments on fixed assets; 23.8% increase in trade, achieving more than 20% increase for five consecutive years; 24.7% increase in national budgetary

revenue; 31% increase in profits at the national level of industries, and so on. It seems that all goes well.

By 2020, compared to other newly developing states like India and Brazil, the size and potential of Chinese economy will still be attractive to foreign investors. Furthermore, the composition of young/old ages in China still maintains at an optimum level for economic growth. However, the challenges for further economic development come from byproducts of economic growth with political implications.

2. China Risk: The Main problems challenging China’s internal stability

In the beginning of 21st century, the term “China Risk” as well as “China threat” became popular among China watchers. The famous report “Fault Lines in China’s Economic Terrain” published by RAND in 2003 already identified eight fault lines, which might seriously affect China’s ability to sustain rapid economic growth and predicted how much they affect China’s growth. The eight lines (weaknesses) are as follows: unemployment, poverty, and social unrest, corruption, HIV-AIDS and epidemic disease, water resources and pollution, energy consumption and prices, fragile finance system and state-owned enterprises, possible shrinkage of foreign direct investment, and Taiwan and other international conflicts. Following the warning of Western scholars, Chinese government think tanks and scholars are also busy alarming the bell of “China in danger,” and have produced numerous articles as well. Table 2 shows the summary of RAND report roughly estimating the potential impacts on China’s annual real economic growth.

[Table 2] Impact on China’s Growth Arising from Separate Fault Lines
2005-2015 (Preliminary)

Types of Setback	Separate Effects Diminishing China’s Economic Performance (percent/year)
unemployment, poverty, and social unrest	0.3-0.8
corruption	0.5
HIV-AIDS and epidemic disease	1.8-2.2
water resources and pollution	1.5-1.6
energy consumption and prices	1.2-1.4
fragile finance system and state-owned enterprises	0.5-1.0
possible shrinkage of foreign direct investment	0.6-1.6
Taiwan and other international conflicts	1.0-1.3

As Charles Wolf, Jr. indicated, most of these fault lines have been confronted by China in past two decades and adequately managed so far. It is highly unlikely everything to be worsened, but neither is unlikely that none will be so. However, some of the fault lines are mutually related, so a problem in a line may instigate others, causing tremendous political problems.

Surveys on social problems in China reveal how Chinese think of their own problems. Chinese cadres and urban residents identified major social issues as in Table 3 and 4.

Chinese cadres took issues of corruption, income gap, and regional inequality seriously while urban residents took unemployment issue as the most serious issue, followed by social safety, housing, environment, and income disparity issues.

[Table 3] Major Social Issues identified by Cadres

Year	Order	1	2	3	4	5
2003		Unemployment	Corruption	Income Gap	Regional Inequality	Peasant Burden
2004		Income Gap	Corruption	Regional Inequality	Social Unrest	Peasant Burden

- In 2004, unemployment issue was ranked by six.

[Table 4] Major Social Issues identified by Urban Residents

Year	Order	1	2	3	4	5
2003		Unemployment	Social Safety	Housing	Environment	Income Disparity
2004		Unemployment	Income Disparity	Housing	Social Safety	Environment

[Table 5] Critical Years of Fault Lines in China

	2005	2010	2015	2020	Points
Economic Growth	8.7%	8.1%	2010~15: 7.5% 2016~20: 6.8%		Overall, 7.5%
Urbanization	42% (550 mil.)	47% (640 mil.)	52% (720 mil.)	57% (810 mil.)	By 2020, 230 cities (Pop. 200 mil.) required.
Labor Forces		2013~16, Peak of Excessive Labor Force No.		Old age pop: 23% (labor forces: 65%)	
Rural Unemployment		Vulnerable Pop. : 300mil (handicapped + unemployed + absolutely poor)			Every year, 20 mil. people moves to urban areas.
Energy/Resources		2013~15: Energy Crisis Insufficient Water Supply Environmental Pollution Crisis			
Disease		More than 10 mil. AIDS SARS, Birdflu, and so on		20 mil. AIDS	20-30% annual growth rate
Political Schedule	2007: 17 th CCP Party Congress 2008: Beijing Olympic Games	By 2010, 11 th Five-year regulation ends. 2010. Shanghai Expo. 2012~13: Fifth generation of leadership			Political Leadership Issue

Sources: Abstracts based upon an internal report on “the national mid to long-term development plan” of the Development Research Center of the State Council headed by Wang Mengkui, Director-General of the DRC.

As in the fault lines of the RAND, the Development Research Center of the State Council

(DRC), a Chinese government major think tank, also identified major problematic issues. According to a report of the DRC, China will confront a bottleneck situation in excessive labor forces, unemployment, energy, water resources, and environmental problems around the year of 2015. The bottleneck situation is closely related to the so called “three rural problems (agriculture, peasants, and rural backwardness),” and high rate of unemployment. The income gap between urban and rural areas has worsened from 1.8:1 in the mid-1980s, and 2.5:1 in the mid-1990s, to the 3.28:1 in 2006. According to a report in 2007 of the Chinese National Statistics Bureau, the gap will widen up to 5 or 6:1, taking into account the subsidies in housing, public sanitation, social safety net, and education of the urban areas. Currently, more than half of the total rural labor forces are considered excessive labor ones. If Chinese rural productivity reaches the level of developed countries, only 40~60 million of people are enough to produce the current level of agricultural products. The others must be absorbed by cities.

Currently, 20 million people annually come to the labor markets. But in 2006, only 11 million people were absorbed, and others were left unemployed. 10 million of work force will increase every year until 2015. Given the excessive labor force in the rural areas, unemployment issue will be difficult to be resolved within the next decade and in fact, it's highly likely to get worsened.

The other sign of social instability is seen in the increase of GINI index in which 1 means an absolute inequality. The GINI index was 0.30 in 1978 and since then, it increased for the next 15 years moderately. However, since the mid-1990s, the GINI increased sharply and reached 0.465 in 2004. Some scholars like Li Chiang argued in 2005 that China had already crossed 0.5 and been close to 0.6, which is a level that social unrest is highly likely to occur.

If Chinese authorities are not able to manage such bottleneck situations, 2015 may be the starting year of political crisis. The 18th Party Congress will be held in 2017 and reshuffle the fifth generation of leadership to form the second terms. If Chinese economy grows much faster to reach US \$ 3,000 per capita even before 2020, social pressure to meet more diversified and stronger political demands with a combination of political leadership transition and the bottleneck situation may cause a serious political crisis in China.

According to recent internal information, a meeting of national security leadership small group(國家安全領導小組) in the early 2007 identified four most serious current issues challenging Chinese national security. Rather surprisingly, despite of the North Korean nuclear crisis and Taiwanese pursuit for a UN seat, key challenges to Chinese national security come mainly from domestic instabilities. Outside challenges were ranked the last among the major challenges. The third most challenging problem was social unrest; the second one energy problem; and the most important one, financial crisis.

Ministry of Public Security sources announced that “mass incidents,” including riots, strikes, demonstrations, and protests participating more than 50 people, steadfastly increased from 8,700 in 1993, to 74,000 in 2004, and to 87,000 in 2005. Mass petitions to government authorities called *xinfang* by a group of people seeking the redress of their grievances have increased at an annually double-digit rate. However, Chinese

authority appears to be more confident in controlling social unrest issues than dealing with energy issues and financial issues.

During the later part of 20th century, China was able to meet most of its energy needs with domestic supply. However, after 2001, China has been forced increasingly to rely on international markets for oil and gas. Its energy demand growth surpassed economic growth. China is now the world's second largest energy consumer and it is in its way to becoming the leading source of greenhouse gas emission. According to an internal estimation, about 60% of China's oil demand may rely on the international markets by 2020. Furthermore, under the conditions of limited development of energy efficiency and increasing demands for more oils and gas, price changes of energy constitute the major risk to sustaining high growth.

However, the hardest area to control appears to be the financial system. The fragility of China's state-dominated financial institutions has been notorious by their high-rate of non-performing loans, which was close to be 60% of China's GDP. The enormously high rate of non-performing loans has been closely related to inefficiencies of state-owned enterprises, policy-lending by local and central governments, the issue of social safety net, and corruption. Since the non-performing loans issue is a structural problem, Chinese government can not find an immediate and easy solution. Furthermore, recent heated investment on stocks and estates among Chinese people provide another source of threat on social and political stability. Recent enormous price increase of estates worsened income and regional disparity problems and placed an enormous pressure on the living costs of the ordinary people. Skyrocketing stock prices already became a political burden. If the stock market collapses for a certain reason, which is vulnerable to outside/inside shocks, it will certainly provide a window of riots against governments. In the last half year, Chinese government has adopted five measures to control the heated investments and stock markets: two times of deposit/lending interest rate increase and three times of required reserve rate increase. However, the effects are still feeble to reverse the current trends.

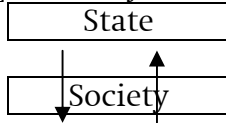
3. Chinese government's Strategy and Responses

Top Chinese leadership has been preoccupied by broad implications of such "fault lines." Chinese government accordingly responded to such alarming. During the period (2006-2010) of the 11th five-year *program* (replacing the term of 'plan') submitted in 2005, Chinese government paid more attention to building a harmonious society than a "rapid economic development." The program provided 63 socio-economic targets in detail, which include targets of 7.5% increase average annual growth rate in GDP, urbanization rate from 43% in 2005 to 47% in 2010, increase in energy efficiency, and more subsidies to poor areas and in education, and so on.

Despite such problems and alarming, Beijing government's confidence in maintaining political stability comes from following several factors. Foremost, Chinese people and intellectuals support the Chinese Communist Party's rule as long as Chinese economy improves. Second, Chinese deep-rooted fear of chaos also contributes the one party rule. Even before the *Tiananmen* incident occurred in 1989, Deng Xiaoping precisely summarized the Chinese fear by emphasizing the absolute necessity for 'political'

stability: “the absolutely crucial task is to maintain (political) stability. Without stability, nothing can be achieved.” Third, no political alternative exists. The Communist Party is the only national level political party in effect.

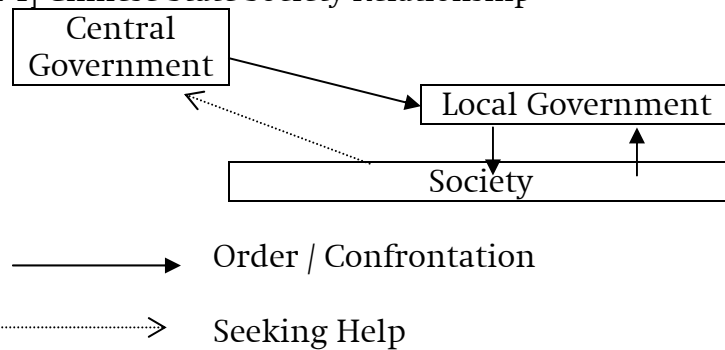
[Chart1] Ordinary State-Society Relationship



Fourth, current governing structure helps Beijing government maintain its legitimacy and political stability. Rioters and protesters generally do not challenge the decisions of central Chinese authorities. Rather, they challenge local authorities and cadres that are predatory and in violation of national policies. They often seek a resolution by prompting the intervention of central authorities. In contrast to ordinary state-society relationship in the developing countries, Chinese state-society relations do not make the relations between the central government and society confrontational because of the intermediary role of local governments. These peculiar relations are illustrated in Chart 1-1.

The relations in Chart 1 are characterized by direct contacts between the state and society. However, as seen in Chart 1-1, local governments in China function like a buffer zone between Beijing government and the society. This situation considerably reduces direct political pressure against Beijing government.

[Chart 1-1] Chinese State-Society Relationship



Fifth, so far, consensus-building mechanism among top political leaders has worked. The Chinese current decision-making structure doesn't allow a charismatic leader to wield power without being checked and it requires consensus-building and collective decision making procedures if the issue is comprehensive and salient. Although the decision-making process has not been efficient, it has prevented outbreaks of political struggle among top leaders and aborted its political system in danger.

Given these conditions, Chinese government would not meet a serious political challenge in a near future by the “fault lines.” However, above conditions do not guarantee political security of the Chinese party-state governance for long. As economy develops, social demands grow stronger and get diversified. One party system will face a

tremendous challenge to meet such demands. As a combination of some fault lines become worsened and at a bottleneck situation, probably around the period 2015-2020 as above mentioned, social and economic problems may turn into a serious political crisis. Especially, by 2020, income and regional disparity problem will be worsening, corruption issue will be hardly improved, and unemployment rate will not be abated. Obviously, Chinese government is aware of the danger and encourages its think tanks and scholars to provide better ideas for better solutions.

4. What is Crucial?

Any of the fault lines will not likely cause any serious internal instability in the near future. Higher danger may be bred in Chinese own power sharing system itself. Capacity for building consensus among top political leaders has been the key for maintaining political stability despite of many serious social, economic and political problems. How to maintain the consensus-building mechanism and smooth power transition will be crucial to predict the future political stability.

Chinese “fault lines” mainly come from structural problems rather than a string of policy errors. The structural transformation from a backward agricultural-based planned economy to a full-fledged market economy was a revolutionary change. During the transitional period, maintaining its political stability and one-party system while developing its economy so fast was a miracle. The miracle has however brought serious byproducts as discussed in the previous chapters. Keeping the miracle was not an easy task and it might be impossible in the future without taking an appropriate and timely measure in response to new social and political environments. In the long run, structural reforms are required, especially, the political system. However, there is no panacea to cure such problems, even with “democracy” to which many Western scholars and the US authorities credibly tie. The core interest of Chinese leadership and people is neither political liberalization nor democratization, but a steady economic development with a combination of social and political stability. The timing, degree, and management of political changes will be crucial for serving Chinese core interests in the long run. These reside in the art of politics.

Chinese top political leadership appeared to recognize the necessity for political reforms as a structural remedy for Chinese characteristics of diseases (fault lines). During the collective study in the Political bureau of the CCP, which started in December 2002 and is held once every month, the issue of democratic governance was raised in June 2006. According to a Chinese source, an active acceptance of the concept of democracy was suggested in the collective study held in March 2007. A Swedish style of social democracy was discussed as a future alternative for Chinese socialist system. If Hu Jintao becomes successful in consolidating his power in the 17th Party Congress, he would actively promote the concept of “democracy” within the Party and “rule of law.” He will try to make decision-making procedures more transparent and improve his legitimacy.

On the other hand, given the serious social problems, as the bottleneck situation ahead of him, it is natural that he would strengthen authoritarian control over society by means of party control and rule of law until 2012. Even after 2012, the newly elected

fifth generation of party leadership may follow the authoritarian rule under Hu Jintao's tutelage while expanding experiments of democracy such as local free elections and free competition at various levels.

The crucial point for Chinese political stability is power arrangement within the top political leadership. Hu-Wen's leadership will more likely place their policy priority on building a harmonious society seeking to resolve the fault lines more actively than others. However, leaders from coastal areas, oil factions, and "princeplings" may place more emphasis on economic developments. For the coming 17th Party Congress, Hu-Wen leadership is quite likely consolidated, but in compromise with Zeng Qinghong. Unfortunately, the fifth generation of leadership has not yet been shaped, so the compromise may lead the leadership formation into trouble. Given the importance of consensus-building in Chinese politics, lack of consensus-building and governing experiences among candidates for the fifth generation of leadership may cause a serious political crisis in managing social crises. The major political crisis will come when Hu Jintao's tutelage becomes wane, the social bottleneck situation worsens, and the fifth generation leaders seek to take their own initiatives.

5. Impact on Regional and International Relations?

Serious internal challenges have forced Chinese political leaders to deal with external issues more cautiously. Since Hu Jintao became Party Secretary in 2002, he and his think-tanks have promoted the idea of peaceful rise of China under the various concepts such as "peaceful rise," "peaceful development," "placing harmony in the first place," and "harmonious world." China's policy priority in practice has been to keep a good relationship with the US. In the North Korean Nuclear crisis, China's policy priority was to maintain peace and stability on the Korean peninsula, not denuclearization. China has made great efforts to have better relations with neighboring countries as well, even conceding in territorial disputes. China also declared that China would not seek a hegemonic power even after China rises.

What China said and seeks are in uncertainty because they are about things of the future. However, Chinese foreign policy behaviors must have been constraint by its tremendous domestic problems. Without fast economic growth and social stability, there is no great China and probably no Communist Party. The evolving nature of Chinese foreign policy must reflect its domestic situations. In the near future, China will focus on its economic development, maintaining social stability and upholding its peaceful foreign policy doctrine. It is undeniable that the World would experience the rise of Chinese nationalism and confidence and militarily powerful China in the future. Some Chinese leaders and more professionalized Chinese bureaucracies, including the PLA, would seek to promote and maximize their own interests in their best.

A worrisome scenario is related to the split of Chinese political leaders and failure of reaching consensus, which can lead to failure of managing the "fault lines." A failed smooth succession is likely to result in such trouble. After 2015, a Chinese leader may seek a top leadership position in the midst of leadership split by adopting more assertive nationalistic measures including foreign policies. Worsening social problems will help such a demagogue mobilize public supports. This situation will have a chain effect in the region and quickly destabilize Northeast Asia.

To prevent this kind of situation, this paper suggests the following recommendations for the interests of Chinese people as well as international society:

1. Recognize positive functions of current Chinese political leadership in maintaining Chinese internal stability, with positive implication of international stability.
2. Recognize a stable and prosperous China as a benefit for international society rather than a detrimental.
3. Recognize Chinese internal stability issue as a shared and international concern.
4. Recognize China's smooth power transition as a positive sign.
5. Encourage independent checks and increase transparency on the Chinese governance.
6. Appreciate changes, see constraints, and think of concrete benefits to liberalization/democratization in China. [End]