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HOW SCARCITY WILL DEFINE
CHINA'S ASCENT IN THE NEXT DECADE

DAMIEN MA



WILLIAM ADAMS

Praise for *In Line Behind a Billion People*

“The hardest challenge in making sense of China’s potential is balancing an awareness of its strengths and possibilities with an appreciation of the obstacles and pitfalls it confronts. Damien Ma and William Adams have found a wonderful, original, and convincing way to portray this tension between China’s strengths and its vulnerabilities. I hope that anyone who plans to do business with, or even think about, China will read their book.”

—**James Fallows**, *The Atlantic Monthly*, author of *China Airborne*

“If you want to know what keeps Chinese President Xi Jinping awake at night, read this book. It describes the daunting economic, environmental, social, and political problems facing China with lively, jargon-free writing and highly informative facts and graphs. A readable, balanced and comprehensive account that I’ll recommend to anyone traveling or doing business in China, and to college teachers.”

—**Susan L. Shirk**, Chair, 21st Century China Program, Ho Miu Lam Professor of China and Pacific Relations, School of International Relations and Pacific Studies, UC-San Diego

“Looking at China through the lens of scarcity rather than abundance is like seeing an infrared picture of a familiar landscape; all sorts of unfamiliar features pop out. Ma and Adams offer a comprehensive, absorbing, and richly detailed account of the many problems on China’s horizon, without falling into boosterism or prophecies of doom. Above all, they underline time and again how China’s scarcities will reshape the global landscape. A valuable read.”

—**Anne-Marie Slaughter**, Bert G. Kerstetter ’66 University Professor of Politics and International Affairs, Princeton University; former director of Policy Planning, United States Department of State

“Damien Ma and William Adams provide an important lens for understanding China’s realities and its future potential. While most of the world’s attention has focused on China’s astonishing growth, Ma and Adams concentrate on the various types of scarcity—from physical resources to social capital to values and political institutions—that confront its leaders and citizens alike. The volume paints a realistic and sobering picture of the country’s profound challenges; it then concludes by placing the future squarely in the hands of political leaders who can still tap huge unrealized potential if they boldly adopt the right reforms. Overall, a stimulating and provocative analysis.”

—**Kenneth Lieberthal**, Senior Fellow, The Brookings Institution

“If you think of China as a country of unstoppable economic and political might, read this book and reflect again. Plain sailing does not lie ahead for Beijing. Adams and Ma argue convincingly that dealing with resource scarcities, as well as social and environmental problems, will almost inevitably replace maintaining high output growth as Beijing’s principal preoccupation. Their picture of social and economic conditions in China today and challenges facing the country is in my view remarkably accurate, comprehensive, and up-to-date. The economic miracle of the past three decades has not only reduced poverty on an unprecedented scale, but also generated social tensions and scarcities of many things, including clean air and water, arable land, many raw materials and public goods such as social justice, social security, food-, drug-, and workplace safety, health-care and education services. The book explains the paradox of rapidly rising living standards on the one hand and growing social unrest and mistrust on the other. It also points to the international spillover effects of scarcities in China. A very readable and important new book on China.”

—**Pieter Bottelier**, Senior adjunct professor, Johns Hopkins University; former chief of World Bank Resident Mission in Beijing

“The authors decipher, in a very crucial way, what will really drive China as it becomes the largest economy in the world. China’s pace of growth will not be the issue, but understanding the levers of government, society, and business in China is instrumental for anybody who wants to be part of such an unprecedented growth story. A must read for business executives who are serious about doing business in China in the coming decades.”

—**Mark Goyens**, Former Asia President of Bekaert, currently business advisor to multinational corporations on growth strategies for China, based in Shanghai

“This book, which draws on the authors’ many years of living in China and their close personal and professional relationships there, is not just another polemic damning or praising China. It instead illuminates the realities and anxieties of a country poorly understood beyond its borders.”

—**Zhang Bin**, Senior Fellow, Chinese Academy of Social Sciences; Head, Department of Global Macroeconomics, CASS Institute of World Economics and Politics

In Line Behind a Billion People

How Scarcity Will Define China's
Ascent in the Next Decade

Damien Ma and William Adams

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© 2014 Damien Ma and William Adams
Publishing as FT Press
Upper Saddle River, New Jersey 07458

FT Press offers excellent discounts on this book when ordered in quantity for bulk purchases or special sales. For more information, please contact U.S. Corporate and Government Sales, 1-800-382-3419, corpsales@pearsontechgroup.com. For sales outside the U.S., please contact International Sales at international@pearsoned.com.

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Printed in the United States of America

First Printing September 2013

ISBN-10: 0-13-313389-3

ISBN-13: 978-0-13-313389-9

Pearson Education LTD.
Pearson Education Australia PTY, Limited.
Pearson Education Singapore, Pte. Ltd.
Pearson Education Asia, Ltd.
Pearson Education Canada, Ltd.
Pearson Educación de Mexico, S.A. de C.V.
Pearson Education—Japan
Pearson Education Malaysia, Pte. Ltd.

Library of Congress Control Number: 2013939746

Damien: For Catherine Hagbom Ma

William: For Fei Yang and Eleanor Adams

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Acknowledgments

This book owes a great deal to the teachers and mentors who shaped our intellectual foundation and that of the contemporaries of our generation. Without standing on the shoulders of giants, this book would not have been possible. Wrestling with the complexity and uncertainty of China has always been a full-contact sport, requiring language skills, cultural acumen, patience, and a healthy dose of on-the-ground experience. It also requires a body of inherited knowledge, whether from those in academia, government, media, private industry, or other practitioners, who paved the way for each successive generation to continue the work of understanding the most important rising power of the 21st century.

To all those mentors and teachers (you know who you are), we owe a great debt of gratitude.

In addition, we want to specifically thank, in no particular order, Jim Fallows, Evan Feigenbaum, Tom Orlik, Pieter Bottelier, Ken Lieberthal, Susan Shirk, Anne-Marie Slaughter, Mark Goyens, Zhang Bin, Jeremiah Jenne, Xiao Yuan, Mary Gallagher, David Gordon, and David Wertime for variously providing useful comments, sharpening our analytical frameworks, and for simply being comrades in arms when it comes to the study of China. And to the China-based journalists, who continue to bring today's China to a Western audience, our work would have been worse off without all your hard work. We also want to thank our editor Jeanne Glasser Levine for shepherding this project, our biggest to date, to its finish line.

We also gratefully acknowledge our employers past and present, especially The Paulson Institute, The PNC Financial Services Group, Eurasia Group, and The Conference Board, for the invaluable insights into China that our colleagues, mentors, and clients have shared with us. Bill also gratefully acknowledges the University of Pittsburgh and its University Center for International Studies and Asian Studies Center for graciously allowing him access to the institutions' world-class China library. And of course, this book represents solely the authors' views and not necessarily those of these fine institutions.

Last but not least, we want to thank our wives, Fei and Catherine, who begrudgingly read and commented on some drafts to humor us. Clearly, we talk about China too much.

China is a country that often surprises and defies attempts to pin it down into simple dichotomies or frameworks, which is why we never get tired of dissecting it and “figuring it out.” Bringing a sense of complexity and reality to observing today’s China is why we decided to write this book. We hope that you enjoy reading it as much as we did writing it.

Damien Ma & William Adams

Chicago, Pittsburgh, April 2013

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Introduction

One Beijing morning in early November 2012, seven men in dark suits strode onto the stage of the Great Hall of the People. China's newly elected Chinese Communist Party (CCP) Chairman Xi Jinping stood at the center of the ensemble, flanked on each side by three members of the CCP Politburo Standing Committee. It was the outside world's first chance to take stock of the committee that will run China for the next decade—one that will mark many milestones. Under Xi's watch, which is scheduled to last until 2022, China is expected to overtake the United States as the world's largest economy. That moment when it arrives will likely lead many in the West to pontificate about the reshuffling of the global pecking order. Inevitably, they will breathlessly proclaim that having held the world's "gold medal" for largest GDP since around the turn of the 20th century, the United States will have to yield to China, the new "number one."¹

That Chinese economic growth has been a success is beyond dispute. Since 2005, China has sprinted past Germany and Japan to become the world's second-largest economy. By the end of 2012, with a GDP preliminarily estimated at \$8.3 trillion, the gap between China and number-three Japan in terms of economic output is as large as the entire French economy. Little wonder that "an American 20th century yielding to a Chinese 21st century" has become a popular refrain, as a flurry of commentators and authors argue that the world should prepare for the possibility that it will once again be centered on the Middle Kingdom.²

The day that China assumes the mantle of world's largest economy will invite both envy and trepidation, and global perceptions could shift rapidly. The approach of this psychological threshold has already led some quarters of the global cognoscenti to declare the irreversible

decline of the American idea as the enduring viability of the China model supplants it. Amid the anticipated “declinist” commentary in the United States and elsewhere, however, too few will pause to ask “so what?” Should China’s continued rise really inspire such alternating anxiety and cheerleading? Yes, China is almost guaranteed to become the world’s leading economic power, but this achievement will paradoxically say less about China’s growing strength and influence than conventional wisdom assumes.

That China will eclipse the United States in absolute GDP terms shouldn’t be particularly surprising—it is, after all, home to four times the population of the United States. But perhaps the speed with which China has caught up with the rest of the world, a pace that not even China’s own leaders anticipated, will be surprising to many. Yet the speed of growth will no longer be the dominant preoccupation of the country. The perennial “bulls and bears” debate on China’s prospects, exclusively focused on the state’s struggle to maintain rapid growth, overlooks a more fundamental truth.

Either a continuation or an interruption of growth is unlikely to alter the country’s sociopolitical core after 30 years of breakneck development. China has, in fact, already weathered several jarring economic cycles since its transition to a market economy, though the country’s statistical system obscured the direct effects at the time.³ If the country were on the verge of economic and political collapse the moment real GDP growth dipped under 8 percent, it would have already collapsed several times by now. In fact, the Chinese economy is more resilient to the business cycle than is typically acknowledged.

Yet in spite of this, the country’s economic and political rise will constrain as much as empower it over the next decade. It will be an era in which the country’s ability to sustain economic growth becomes less of a concern. What instead will define China is also what has always defined it: scarcity.

The crucial and intersecting challenges of scarcities, both emerging and intensifying, will consume China’s custodians over the next decade. Scarcity is the keen lens through which the economic, social, and political constraints that accompany China’s rise can be seen most clearly. Economic dimensions of scarcity are perhaps the most obvious and are subject to frequent discussion. China’s supplies of natural

resources and labor, the critical inputs that have sustained its stellar growth, are increasingly stressed. Resource scarcity is about to force difficult changes in China's growth model, whether the country is prepared or not. Food, too, faces renewed supply constraints as burgeoning Chinese consumption adds a new set of pressures on domestic production. But as previous decades have witnessed, what happens in China can rarely be contained within its borders. These challenges of scarcity will have far-reaching implications for global supplies, global prices, and global politics.

Although they undeservedly receive much less attention from observers outside China, social dimensions of scarcity will pose as much if not more of a constraint on the country as economic scarcity over the next decade. Whether it is healthcare, education, or the social safety net, public goods in China are in short supply even considering the country's level of economic development. Social dimensions of scarcity, more than simple matters of supply and demand, are also symptoms of intensifying Chinese inequality. Over the three decades in which the Chinese government shifted its emphasis from "class struggle" to economic development, the deepening of inequality has coincided with, and in some ways spurred, the emergence of new social classes in China. New categories such as "elite," the "middle class," and the "migrant class" are far cries from the simple bifurcation of proletariat and capitalist during the halcyon days of communism. Most members of all three groups live materially better lives today than at the end of the planned economy in 1978. But unequal distribution of both the burden of paying for public goods and the access to them often overshadows an aggregate improvement in general welfare.

The emergent middle class and migrant class—that is, the two groups that comprise the majority of China's population—find themselves increasingly in competition over access to social welfare services. The country's sheer scale and density virtually guarantees that competition for social goods like healthcare and pensions will be fierce; structural inequality serves to make what is already scarce even scarcer. What's more, rapid changes in China's demographic structure—with retirees multiplying exponentially and the labor pool stagnating—mean that demand for social goods is rising at the same

time that future supply remains in limbo, exacerbating anxieties over scarcity.

Migrant and rural grievances center on the scarcity of opportunities for educational advancement and related barriers to their equal membership in urban life. China's public health, education, and retirement systems are designed in part to keep urbanites happy at the expense of rural Chinese; they are biased toward urban areas. These policies ensured urban support of the social and political status quo when city dwellers recognized that the government was prioritizing their privileges over their more easily controlled, isolated, farm-bound country cousins. But today, when "rural" Chinese float itinerantly from city to city and share information instantly over their mobile phones, this old stabilizer has become a political liability.

Urban middle-class anxieties, in contrast, revolve around the indispensable public goods that they cannot simply buy from the private market: principally among them, the guarantee of safe food, clean drinking water, and healthy air to breathe. And even though they stand ahead of rural Chinese in line for college entrance and hospital admission, urban residents, too, feel hard pressed by the scarcity of good job opportunities for a college-educated workforce. More recently, "the good life" they should be able to provide their families has become a moving target as expectations constantly rise one step ahead of reality. This scarcity of public goods is experienced at a micro level, but has profound macro implications. For instance, how can a hamstrung education system generate the human capital to build an innovation economy? How can the "only-child generation" trust their sick or retired parents to the care of a social safety net punctured with holes?

Similarly, political and institutional scarcity will hamper China's global ascent, even as the country marches toward economic leadership. A paucity of individual freedoms, compelling values, and ideological sustenance will constrain the country's progress and undermine its government's amply funded image-building efforts. To be sure, average Chinese people are freer today than ever before to choose their job, their spouse, where they live, the entertainment they enjoy, and the language with which they express discontent with

the government—freedoms that make the shrinking body of topics that they *absolutely must not discuss* seem comically anachronistic. Mainstream Chinese do not necessarily believe that a government “by the people” is the optimal option for China. But they do appear to yearn for a government that is “for the people.” The issue for most in the Chinese middle class isn’t one of better political models but rather one of expectations for transparency, accountability, and legal norms from their rulers. In the age of instant information and constant connectivity, the Chinese public has little tolerance for a dishonest and opaque government.

The Chinese public has up until now accepted the government’s grand bargain: staying out of politics in exchange for prosperity. But will they continue to do so when social equality and good governance trump material welfare as their top concerns? As the CCP gropes for a post-economic growth platform for its rule, the scarcity of values, beliefs, ideas, rule of law, and freedoms that are the hallmarks of an open and tolerant political system becomes harder and harder to ignore. Justifying the party’s governance will now depend on delivering on middle-class demands for competent, humane, and accountable governance.

The vast majority of Chinese still believe that the state ought to play a strong role in the economy, certainly a stronger one than that played in the United States. But they are no longer content with the outsized role the state played in the past. In various ways, they appear to be demanding that it retreat from the economic and social realms to create more room for individual freedom and the flourishing of innovative and entrepreneurial dynamism—for the modernity to which China aspires. As more and more Chinese people spend time overseas and seeing the country from the outside becomes familiar, the Chinese public is already recognizing that they too have a say in their country and its global image. That is, in fact, how enduring soft power is accumulated.

This book explores the economic, social, and political scarcities that we believe will be China’s chief challenges and preoccupations over the next ten years. Each chapter focuses on a priority or theme that will dominate the administration of Xi Jinping and Li Keqiang.

We begin with the most concrete—economic scarcity—and conclude with the more intangible political scarcity.

Economic scarcity

1. Resources: While supplies last

China has pursued an incredibly resource-intensive growth model despite having among the world's lowest per capita supplies of arable land and water. The country's resource scarcity uniquely combines unprecedented intensity of need with massive scale. The transition from an investment- and export-intensive growth model to one focused on domestic consumption will likely sustain economic growth. But the hundreds of millions of Chinese consumers increasingly aspiring to consumption- and energy-intensive lifestyles that would be familiar to any American will impose severe stresses on already strained natural resources. China's scarcity could easily become the world's scarcity over the next decade—and the “China price” may soon refer to expensive natural resources instead of cheap manufactured goods.

2. Food: Malthus on the Yangtze

The Chinese government has strived for decades to preserve food security, impressively achieving the feat of feeding nearly 1.4 billion people. Yet meeting this goal tells only half the story: “food security” as the government defines it omits huge and growing amounts of imported agricultural products that China relies on to keep food, and in particular meat, on dinner tables. Chinese technocrats will turn to better technology and more efficient production to keep food plentiful, but the bar for success may be impossibly high. As demand for meat grows over the next ten years, and China's agricultural land risks shrinking further, its dependence on imports will most likely grow. Food and commodity prices around the world can be expected to rise inexorably as foreign dinner tables become increasingly priced to Chinese scarcity. The mutual recrimination and blame games that rising food prices will likely inspire could make for an era of ugly global politics and diplomacy indeed.

3. Labor: Where did all the migrants go?

Demographics are changing faster than the Chinese government anticipated. The country is on the cusp of a shift from its era of an enormous labor surplus windfall to one in which labor is becoming scarce—from “demographic dividend” to “demographic hangover.” This is particularly visible in the migrant workforce, with a younger generation bringing higher demands and aspirations as an older generation exits the workforce. Rising labor costs are pushing manufacturers to replace workers with more machines or to reconsider earlier decisions to relocate production from advanced economies. Within China, the onset of this structural scarcity is helping the economy transition to a more sustainable model of growth. But it is also creating new challenges: rising fiscal obligations, pressure on the national balance sheet, and the potential emergence of a young and unruly migrant-class labor movement.

Social scarcity

4. Welfare: Socialism with Chinese... actually no, not socialism at all

If you think American healthcare is in disrepair, try visiting a Chinese hospital. Rising episodes of hospital violence, including a spate of stabbings, are symptoms of an ailing healthcare system in which corruption and spiraling costs drive patients to extreme action. The horrendous state of the social welfare system is beyond simple demand and supply considerations. A man-made and policy-induced scarcity of reliable, affordable healthcare and an underfunded pension system compound the insecurity of average Chinese people. As demands for a better system grow, the government is struggling to prevent a revolution of rising expectations.

5. Education: Give me equality... but not until after my son gets into Tsinghua

Admission slots in choice schools are scarce in China’s intensely competitive educational system. But the very uneven distribution of

these scarce opportunities is even more important to understanding education in China, and its role in Chinese society, than is the average degree of scarcity. Beneath the ostensibly meritocratic system of national test-taking lies an educational system that, like much of the country's welfare state, reserves premium opportunities for holders of urban household registrations. One or two generations ago, this was a force for social stability, keeping potentially unruly urbanites invested in the status quo. But today, the educational system's bias toward urban-registered households actually serves to destabilize Chinese city life. That's because of the systematic discrimination against the migrant class, a group that increasingly and perhaps uncomfortably resembles the kind of "proletarian mass" from which orthodox Marxists would expect social revolutions to rise. Something has to give.

6. Housing: Home is where the wallet is

The housing market was a tremendous driver of growth during the first decade of the 20th century. It also served an important role in maintaining social stability: providing wealth to the emerging middle class, job opportunities to the migrant class, and huge fortunes to the elites. It is such a perfect microcosm of everything that makes the Chinese economy tick that economics professors would have to invent it if it didn't already exist. But the tailwinds that made housing an indisputable boon to developers, investors, and tax collectors over the past decade have now turned into headwinds that could hamper economic and social development. Demographic, economic, and political pressures converge to create an impression of chronic scarcity in China's housing market. The threat of a collapsing real estate bubble may preoccupy foreign observers, but it's the pervasive sense of scarcity of affordable housing that remains a pressing concern for the average urban Chinese family.

Political scarcity

7. Ideology: The unbearable lightness of the Yellow River Spirit

Ask any serving Chinese civil servant what the Yellow River Spirit is and your question will likely be met with a dumbfounded look. So it

should be unsurprising that tens of thousands of aspiring Chinese civil servants were stumped when they were asked in the final question of the 2011 civil service exam to expound on the meaning of the obscure reference. “Yellow River Spirit” sounds indistinguishable from any number of party slogans—“harmonious society,” for example—but in fact means basically nothing. China has begun to select its civil servants in part based on their ability to convincingly defend an ideological cipher, an important skill for members of a political party that no longer knows what it stands for but must still win the hearts and minds of its citizenry. The CCP has for a generation now defined itself through pragmatism, delivering economic growth in exchange for the mandate to govern. But this grand bargain is breaking down, and will become only more fragile over the next decade—drawing increasing attention to the party’s ideological scarcity and confusion over what it stands for.

8. Values: What would Confucius do?

Having completely abandoned communism, the political system has to actively recruit members who can convincingly espouse just about any ideology, or none at all. In a country where all moral life is political, the wishy-washy values and fuzzy principles of China’s politics translate directly into a level of emptiness in the lives of average Chinese people, who increasingly seek new avenues for spiritual sustenance and collective national renewal. Yearning for deeper meaning in life has fueled one of China’s more serious domestic conflicts of the last 20 years—between the government and religious practitioners—which will only intensify as China’s last few tottering octogenarian true believers in utopian Marxism pass away. The growth of the middle class and its post-material yearnings creates unprecedented challenges for the Chinese leadership to provide social stabilizers beyond what material prosperity alone can offer.

9. Freedom: Keep on rockin’ in the firewalled world

Chinese people indisputably lead much freer personal and political lives today than ever before. But individual political freedoms are still in short supply and unequally distributed. While few seriously champion Western-style democracy in China, many more crave the

freedom of expression, of the press, of mobility, and of thought common in almost all developed countries. So far, the state has done a spectacular job at stifling demands for the individual freedoms that it associates with social instability. But society is growing stronger, its demands amplified by new media. The party-state's default impulse to control is increasingly at odds with a middle class that believes more personal freedom *should* be part of the social fabric. Like previous middle-class formations in other countries, the shift from wealth accumulation to rights advocacy is gradually taking place. The government must adapt and respond credibly or risk losing the loyalty of its most important political constituency.

Whatever China has done it has done in a hurry. A decade's time at Chinese speed creates as much change as occurs in other countries over one or two generations. Yet speed, whether it be GDP growth or an aging society, will be counterproductive to the coming era of Chinese development. China can rest assured over the next decade that it will have significantly narrowed the economic gap with the developed world, barring some unforeseen collapse of growth. The gaps that it must now narrow, after much neglect, are social and political. Each one of its challenges is formidable in and of itself. But the convergence of all three—economic, social, and political—will require Beijing to harness all the resolve and ingenuity at its disposal.

The new Chinese leadership faces a stark choice: summon its political will and forge forward boldly, risking destabilizing changes along the way, or keep its finger in the dyke and risk losing itself and the Chinese public to festering, pervasive social discontent. The political system has absorbed discontent and de-escalated seemingly intractable conflicts more than once—whether it can do so again, without significant changes, remains a looming unanswered (and unanswerable) question.

In the meantime, as outside observers expect the world's soon-to-be biggest economy to exert ever more influence globally, and its own population's expectations rise, Beijing's mandarins face an unprecedented post-development narrowing of options and acute pressure to usher in considerable changes to its political economy. It is these intense pressures and the difficulty of managing change

that will dictate the country's behavior, ironically making China a very reluctant economic superpower, begrudgingly pulled into the global spotlight.

Ultimately, a balanced and nuanced portrait of today's China is one of a nation of great aspirations, great achievements, and great limitations. China will need to make fundamental changes to its economic and political ecosystems over the next decade to prevent its limitations from overwhelming its aspirations. But the dramatic transformations that have sprouted every ten years or so since the founding of the modern Chinese republic are reasons to believe that changes will come, if not willfully, then by the indomitable force of necessity.

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