

# BTI 2012 | China Country Report

<b>Status Index</b>	1-10	<b>4.94</b>	# 82 of 128	
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scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

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### Key Indicators

Population	mn.	1338.3	HDI	0.687	GDP p.c.	\$	7599
Pop. growth <sup>1</sup>	% p.a.	-	HDI rank of 187	101	Gini Index		41.5
Life expectancy	years	73	UN Education Index	0.623	Poverty <sup>3</sup>	%	36.3
Urban population	%	44.9	Gender inequality <sup>2</sup>	0.209	Aid per capita	\$	0.9

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

No other major economy matched China's economic performance in 2009 and 2010, during the financial crisis. With growth rates of 9.2% in 2009 and 10.3% in 2010, China has surpassed Japan as the world's second-biggest economy, and in 2009 became the biggest exporting country, ahead of Germany. However, its massive \$586 billion stimulus plan has worsened China's dependence on fixed asset investment, while the huge sum of new credit provided in 2009 (\$1.4 trillion) and 2010 (about \$1.1 trillion) may drive inflationary pressures, asset bubbles and trigger a new wave of non-performing loans in the banking sector.

Just two years ahead of the next Chinese Communist Party (CCP) congress in 2012, a fifth generation of party leaders was already poised to take over from President Hu Jintao and Premier Wen Jiabao to ensure a smooth transition of power. Even though attempts have been made to increase the transparency and accountability of party and government, these have aimed at enhancing regime control over state and society by improving governance and strengthening party supervision. During the review period, there were no significant political reforms. China's leadership continues to strongly resist any calls for increased political freedom, competition or participation. Furthermore, fundamental civil rights continue to be denied, as illustrated by violent crackdowns on protesters and the political opposition, and the harsh 11-year prison sentence against dissident Liu Xiaobo, who was awarded the Nobel Peace Prize in December 2010. Important problems which threaten to undermine further development and the CCP's hold on power remain unresolved. The most pressing of these include social inequality and the associated increase in popular unrest, ongoing ethnic tensions in Tibet and Xinjiang, deepening regional developmental disparities, insufficient social security systems, corruption, and environmental degradation.

In its external affairs, China was able to portray itself as an indispensable economic partner that pulled the world economy – and in particular countries such as Australia, Brazil, Germany and

South Korea – out of the recession due to its enormous need for resources, capital and consumer goods. On the other hand, China has been criticized for increasing assertiveness vis-à-vis its neighbors and its “mercantilist” economic policies (undervaluation of the yuan, export restrictions, market access restrictions, etc.).

## History and Characteristics of Transformation

China’s “Opening and Reform Policy” initiated a period of economic transformation in 1978. After the upheaval of the Cultural Revolution, the Chinese leadership emphasized economic and political consolidation. Despite initial structural deficiencies, economic reforms benefited from preconditions seldom found in developing countries: The large rural workforce facilitated the recruitment of cheap labor for the emerging industrial sector, and despite the existence of a planned economy, the public sector remained rather limited. These specific circumstances facilitated economic development to a substantial degree.

A determined consensus among the leadership to follow the Opening and Reform policy drove economic reforms. However, following the 1989 Tiananmen massacre, when the People’s Liberation Army (PLA) violently cracked down on a pro-democracy movement led by students, there have been no attempts to increase political accountability, competition or even initialize democratic reforms. In the aftermath of the “incident,” which remains taboo to discuss in the official media, political reformers were purged from the CCP leadership. Since that time, party and state elites have been united in their commitment to limit reforms to the economic arena, and to reject any meaningful political reforms or liberalization.

Economic reforms proceeded gradually, experimentally and in a decentralized manner, avoiding the transformational “shocks” that occurred in the Russian Federation, for example. Absent a detailed road map, the Chinese leadership allowed reform initiatives from lower administrative levels to be implemented locally, learning from a process of trial and error. If successful, these local initiatives were adopted as national policies. Most important for the maintenance of economic stability was the leadership’s decision to let the planned economy and the gradually emerging private sector coexist. During the reform process, the de facto economic importance as well as the political appreciation of the private sector increased steadily.

Economic reforms were accompanied by yearly growth rates of almost 10% from 1978 to 2010, as well as relatively low levels of inflation. Even the global financial crisis of 2008 –2010 has done nothing to interrupt this trend. Living standards have improved significantly, and the number of absolute poor has decreased by 300 million since 1978, so that only 9% of the population lives in poverty today. This overall success is clouded by the increasingly uneven spread of wealth. Urban incomes today are 3.3 times those of rural incomes, and in 2007 the richest 10% of Chinese earned 23 times as much as the bottom 10%.

Rampant corruption, an inefficient legal system, government agencies unable to properly implement laws and regulations, and a lack of sustainability associated with the country's economic development constitute other serious problems. Environmental deterioration will cause enormous economic and social costs in the future, and burden further development. In addition, China's government is increasingly under pressure to fulfill the demands of the population for better public goods (reliable social security, health care and pension systems, working infrastructure), affordable housing, career opportunities and more governmental accountability. Although the party has been able to win the growing support of the young, well-educated urban middle class, social unrest is increasingly common on the part of people who lack access to institutionalized channels to express their grievances, and who have thus resorted to riots and violent clashes with authorities in order to make their case.

The current leadership, headed by President Hu Jintao since his confirmation in office in October 2007, is determined to widen its focus from an exclusive concentration on economic growth, and take the often negative social consequences of economic development into consideration. Contrary to outside expectations in the run-up to the 2008 Olympic Games, there have been no improvements in the areas of human rights, rule of law and democratization since the hosting of the event.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 10 (best) to 1 (worst).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

The nation's existence as a state is taken as a certainty, and there is virtually no competition with the state's monopoly on the use of force. With the important exception of continuing secessionist activities in the autonomous regions of Xinjiang and Tibet, the state's monopoly on the use of force is largely unchallenged, and even these regions represent exceptions of relatively minor relevance.

According to the Chinese constitution, China is a unitary, multinational state. Most citizens seem to accept and support the People's Republic of China (PRC) as a legitimate sovereign nation state. However, considerable pressure is applied by Tibetan and Uyghur secessionist movements that have become increasingly frustrated with their lack of effective political and cultural minority rights and of equal opportunities in economic life. These grievances have led to a demand for more autonomy and an increase in clashes with members of the Han majority within these regions, culminating in violent civil unrest in March 2008 (Tibet) and July 2009 (Xinjiang). However, the increasingly assertive stance taken by Tibetans, Uyghurs and other minority nationalities over their rights has led to higher degrees of repression.

The state is defined as a secular order; religious dogmas have no influence on politics and/or the law. Only five religions – Protestantism, Catholicism, Buddhism, Daoism and Islam – are officially recognized, with all five strictly controlled. With the ongoing erosion of communist ideology and traditional Chinese family values, people have demonstrated an attraction toward spirituality. Thus, a number of other religions of various kinds, including folk religion and ancestor worship, have attracted increasing numbers of adherents. The government is tolerant of the revival of these various forms of religion in the belief that it will foster social cohesion.

Question  
Score

Monopoly on the  
use of force

9

State identity

8

No interference of  
religious dogmas

10

In the PRC, a fundamental and sufficiently differentiated bureaucratic structure extends throughout the entire territory. In some rural areas, however, the infrastructure is weak, and access to basic utilities remains lacking. Furthermore, conflicts between different layers of the administration persist, sometimes of an aggravated nature. In particular, it has become increasingly difficult for the central government to ensure that national policies are implemented correctly by lower administrative levels.

Basic  
administration  
8

## 2 | Political Participation

Authorities at the national level are not selected through free and competitive general elections. Overshadowed as they are by the power of the CPP, the indirect elections of the National People's Congress through subnational congresses do not qualify as general elections following the BTI's normative foundations. Limited venues for participation exist at the local level, such as elections to select the members of village and urban residents' committees and local people's congresses, and to choose lower-level government and party officials. Candidate nominations, voter eligibility and election campaigns are still subject to local government and party control and manipulation.

Free and fair  
elections  
1

China's political authorities have the effective power to govern without being overruled by veto powers. The military is under the control of the civilian party leadership. However, rulers at the central level are not democratically elected. Instead, delegates to the national legislature (the National People's Congress) and all leading political and government positions are filled by an internal selection process controlled by the Communist Party.

Effective power to  
govern  
2

Although freedom of association and assembly is ostensibly ensured by the constitution, the state often interferes with this right. The number of registered civil society organizations in China has increased from 154,000 (2000) to 415,000 (2009), but these organizations are not allowed to operate independently; instead, the state requires them to register with the relevant state agencies and places them under tight supervision. Meaningful political opposition organizations, including "opposition parties" such as the China Democratic Party, are prohibited and subject to repression. Particularly in 2009, with its sensitive anniversaries (Tiananmen in 1989, the founding of the PRC in 1949), surveillance of NGO activities and of individual activists was significantly intensified, with many activists harassed, put under house arrest, forced to leave the capital or arrested by state organs. Since the government fears that strong NGOs could limit state control over society, only those NGOs deemed to be at least superficially apolitical are tolerated by the regime. These often act as providers of beneficial services, such as after natural disasters or in areas where the adverse effects of economic development are adversely affecting people's lives (dealing with issues of environmental protection;

Association /  
assembly rights  
2

health care/AIDS; support for the disabled, orphans, etc.), stepping in where governmental agencies lack the funds and/or the will to provide relief themselves.

Although technically guaranteed by the constitution, freedom of expression is still severely limited. But Chinese citizens increasingly make use of modern mass communication technologies to express their views, raise public awareness and criticize government actions. The government has reacted to this challenge by tightening controls on these technologies, employing means such as shutting down websites and chat rooms or blocking text-message services. The email correspondence of political activists is spied on, a fact that has resulted in the detention of several bloggers and other cyber-dissidents.

Most influential media organizations are controlled and/or owned by state organs, and the work of journalists is heavily monitored by the CCP. Reporters Without Borders ranks China 171st out of 178 countries (2010) in its Press Freedom Index. Journalists deviating from the official line are likely to have their work removed from publication, and to be fired. During and after the violent unrest in Xinjiang Autonomous Region in July 2009, censorship increased further; for example, mobile phone communication and text-message services were interrupted for months.

After the anti-crisis stimulus plan was rolled out in 2008 and 2009, the government took pains to report in detail on the fund's disbursements, seeking to alleviate the population's concerns over corruption. Since the Chinese government has realized it is impossible to block any bad news altogether, it now tries to control negative information and its impact by publicizing the news. In spite of nominally relaxed regulations for foreign journalists in effect since the Beijing Olympics, the Foreign Correspondents Club of China reported 178 cases of interference with foreign media in 2008. China continues to filter foreign Internet content successfully. Google, which in March 2010 temporarily closed its mainland search engine, submitted to censorship again in June 2010 in order to win a new license from the authorities. On the other hand, the plan for the so-called Green Dam Youth Escort – a content-control software program that was to be mandatory for every new computer sold after July 1, 2009 – was dropped after massive public resistance and international criticism.

### 3 | Rule of Law

China's political system is characterized by the Leninist principle of concentration of state powers, with the National People's Congress (NPC) as the formally highest organ of power. In principle, all state organs, including executive and judiciary bodies at the central level and the local levels, are responsible to the NPC or local people's congresses at their respective level of government. Thus, the constitutional

Freedom of  
expression  
2

Separation of  
powers  
2

framework does not establish a system of separation of powers. Since the Chinese Communist Party (CCP) is constitutionally defined as the leading political power, it is regarded as superior to the state institutions, and the NPC and local people's congresses are subject to CCP directives and control. Thus, there is no active system of checks and balances or of subordination of the party and state powers under the law.

Although the judiciary is institutionally differentiated, it is not independent. Despite President Hu's stated commitment to the rule of law and its importance for establishing a "socialist democracy" and "harmonious society," China's legal system remains tightly under the control of the CCP, and interference with the work of the judiciary still occurs frequently. Particularly at the lower level, judges are very susceptible to corruption. The bar too lacks independence, as the All-China Lawyers Association is institutionally subordinated to the Ministry of Justice. Particularly in cases dealing with alleged criminal activity or a defense of rights, lawyers face restrictions on their ability to conduct investigations and gather evidence. Lawyers often face accusations that they have themselves violated the law when representing defendants. The trial against Liu Xiaobo and the defendant's harsh sentence (11 years in prison for "inciting subversion of state power") in December 2009 highlighted the ongoing deficiencies in the judicial system. Since 2007, when the authority to review death sentences was given back to the Supreme People's Court, the number of death sentences and immediate executions has dropped significantly.

Independent  
judiciary  
2

Although laws against corruption are in place and punishment is severe, implementation remains highly inadequate. In most cases, prosecution is performed by the CCP's disciplinary organs, with only a fraction of cases submitted to the state judicial organs. Only at the lower administrative levels are corrupt government and party officials punished with any frequency. At the higher and central levels, corrupt officials are mostly able to escape punishment. Only a few "showcases" have been given extensive media coverage in order to substantiate the CCP and government's determination to reign in corruption. The Chinese public is highly concerned with official corruption, and frustration with inefficient countermeasures has grown. Today, corruption is one of the primary causes of large-scale social unrest in China.

Prosecution of  
office abuse  
3

The constitution guarantees certain civil rights such as the freedoms of speech, of the press, of assembly, of association, of demonstration, of religious belief, of person, etc. Nevertheless, CCP and state organs frequently interfere with these rights. For example, religious/spiritual groupings, such as underground protestant churches and Catholic communities that give allegiance to the pope are not tolerated by the authorities, and activists are frequently persecuted. Maltreatment, physical abuse and torture of prisoners are prevalent. The country's strict birth control policy remains in place, leading to cases of forced abortion or forced sterilization. In rural

Civil rights  
2



areas, the state is unwilling or unable to prevent large-scale human rights violations by private actors, resulting in widespread forced labor, abductions and human trafficking. Compulsory resettlement due to large-scale governmental construction projects or illegal land grasps by local authorities violates people's property rights. Ethnic minorities are politically and economically discriminated against, as public life is dominated by Han Chinese, and minority regions lack significant autonomy rights. Although the Chinese constitution stipulates that both men and women enjoy equal rights, and legislation protecting women's rights has been place since 1996, in practice, women's rights and opportunities are still severely compromised in many parts of the PRC. While in principle, victims can seek redress for such violations, corruption and the lack of judicial independence hampers the efficacy of these mechanisms.

#### 4 | Stability of Democratic Institutions

The formal arrangement of political institutions is characterized by the supremacy of the CCP; thus, the political system of the PRC can be classified as a centralized socialist dictatorship. All leading political personnel are recruited from party ranks. Other political organizations in competition with the CCP are interdicted and suppressed. There are no meaningful general elections through which the people could change the government. The judiciary is not independent; particularly in "sensitive" cases involving public disturbances, state secrets, product safety, and other such issues, political involvement in the judicial process and in decision-making is frequent.

Performance of democratic institutions

1

Political leaders have rejected representative democratic government, though they endorse the direct election of village and urban residents' committees and encourage greater transparency and popular participation in local governments. However, these measures are not intended to influence developments at the central level, but are rather aimed at improving good governance and strengthening party supervision.

Commitment to democratic institutions

2

#### 5 | Political and Social Integration

The party system is dominated by the CCP; even though a number of so-called democratic parties are officially recognized, they are subordinated to the CCP. CCP membership has grown to 78 million persons (2009), with private entrepreneurs and self-employed individuals representing a disproportionately high share of new members. This means that the new urban middle class, a chief beneficiary of economic reforms, now constitutes the backbone and most important social base of the CCP. Peasants and urban industrial workers have in the process become

Party system

1

marginalized. Although there is no competitive party system, the CCP is stable and socially rooted, and the party does articulate and aggregate societal interests.

In China, the system of cooperative associations is very heterogeneous, and characterized by differences in the relationship to the state. Former mass organizations are funded, controlled and supervised by the state, and mainly operate as purveyors of CCP policies to their members. The majority of associations have been established on the initiative of the state and count as GONGOS, or government-organized non-governmental organizations. There are also NGOs, which typically concentrate mainly on social issues such as environmental protection, animal welfare or the representation of the interests of marginalized groups (women, the disabled, ethnic minorities, children), and provide services such as legal aid or consumer protection. China has a thriving state-approved nonprofit sector in which informal, nonregistered associations (approximately 2 million in total) are active in areas such as environmental protection, alumni activities or self-help. However, NGOs are poorly connected, and lack organizational capacity and funding. As the state tightly controls the working of social associations and rigorously bans politically undesirable NGO activities, large interest segments remain underrepresented.

Many Chinese citizens have only vague ideas about democracy and often reveal a conflicting understanding as to the concept's meaning. According to the World Values Survey, they generally have a positive view of democracy; almost 90% of the country's citizens consider it – despite some problems – to be a form of government better than other alternatives. However, the broad interest in a responsible, non-corrupt and predictable form of government has not yet led to claims for political participation. Most Chinese still believe that a strong government able to guarantee stability and order is needed. Even if many Chinese today are strongly critical of governmental arbitrariness and officials' chicanery, the overwhelming power of the state dissuades them from demanding democratic participatory rights or attempting to become personally engaged in politics.

According to surveys, levels of interpersonal trust are extremely high in China, almost on par with that found in Scandinavia. Parochial trust, or strong loyalty between family members, is particularly pronounced. Civic trust is also growing as citizens affected by severe problems such as environmental degradation, local government corruption, violations of basic human rights and other such problems associate for purposes of self-help. Occasionally, these associations are supported by activist lawyers. These groups are closely watched, and since they often aggressively bring social ills and wrongs to the fore, local governments in particular try to silence them by repressing activists and leaders.

Interest groups  
2

Approval of  
democracy  
n/a

Social capital  
4

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Question  
Score

Socioeconomic  
barriers

5

In spite of China's continuing economic growth and a further reduction of poverty during the review period, large shares of the population remained excluded from society due to stagnating social development and rapidly increasing inequality. However, the reduction in poverty rates has continued, with 9% living in absolute poverty in 2009 (according to official Chinese data) compared to 15.9% living on less than \$1.25 a day in 2005. China's Human Development Index (HDI) score rose slightly from 0.648 in 2008 to 0.663 in 2010, keeping the country within the medium development range. The overall distribution of income, as measured by the Gini index, was at 0.475 in 2007 (the latest available figure), indicating very high inequality. There are considerable and growing discrepancies between urban and rural areas as well as between provinces. In 2009, per capita disposable income in urban areas was CNY 17,175 (\$2515) as compared to CNY 5,153 (\$755) in rural areas. The urban-rural income gap has widened from a ratio of 2.79:1 in 2000 to 3.3:1 in 2009. Living standards and levels of development also vary widely, with Shanghai showing the highest levels and Tibet the lowest.

Traditionally, Chinese women were well integrated socially and economically, and recent years have seen an increase in women's employment and self-employment rates. China's Gender Inequality Index (GII) score was 0.405 in 2008 (latest available figure), ranking the country 38th worldwide, while its Gender Empowerment Measure was 0.53 (2006). However, gender discrimination exists in the labor market and shows signs of worsening. Women's participation in politics remains minimal. Women account for 31.9% of all CCP party members, but are heavily underrepresented in the top party organs (the Central Committee and the Politburo). The share of women in the National People's Council remained at around 21.3% between 2009 and 2011. Political gender inequality is particularly drastic in rural areas, where women occupy only 1% to 2% of local decision-making positions.

Ethnic minorities are subject to social and economic exclusion and marginalization, with the majority of China's poor living in minority regions, and 20% of non-Han Chinese counting as poor. Political marginalization, infiltration by Han Chinese and economic backwardness has provoked often-violent resistance and separatist movements, most prominently in the Muslim Xinjiang Uighur and Tibet

Autonomous Regions, both of which have witnessed large-scale, violent incidents of civil unrest in recent years, respectively in April 2009 and March 2008.

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	3494055.9	4521827.3	4991256.4	<b>5926612.0</b>
GDP growth	%	14.2	9.6	9.2	<b>10.4</b>
Inflation (CPI)	%	4.8	5.9	-0.7	<b>3.3</b>
Unemployment	%	4.0	-	-	-
Foreign direct investment	% of GDP	4.6	3.9	2.3	<b>3.1</b>
Export growth	%	19.8	8.4	-10.3	<b>28.4</b>
Import growth	%	13.9	3.8	4.1	<b>20.1</b>
Current account balance	\$ mn.	353996.5	412363.8	261120.2	<b>305374.0</b>
Public debt	% of GDP	19.6	17.0	17.7	<b>17.7</b>
External debt	\$ mn.	373083.2	379800.1	432197.5	<b>548551.0</b>
Total debt service	\$ mn.	31810.6	33256.4	39778.7	<b>62610.7</b>
Cash surplus or deficit	% of GDP	-	-	-	-
Tax revenue	% of GDP	9.9	10.3	-	-
Government consumption	% of GDP	13.5	13.3	13.4	<b>13.4</b>
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	4.2	4.3	4.6	-
R&D expenditure	% of GDP	1.44	-	-	-
Military expenditure	% of GDP	2.1	2.0	2.2	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

## 7 | Organization of the Market and Competition

In December 2008, as the global financial crisis mounted, price controls on basic goods and services that had been in effect since 2004 were lifted in order to prevent the development of deflation. In November 2010, however, as consumer price inflation reached 5.1%, controls on food prices were reintroduced.

Market-based  
competition

6

In part due to the financial crisis, the Chinese yuan was tightly pegged to the dollar from autumn 2008 until June 2010, when China returned to a managed-float exchange rate regime. However, China has not given in to U.S. pressure to let the yuan appreciate significantly, leaving the currency undervalued by as much as 15% to 40%.

In general, the government recognizes the importance of the private sector; by the end of 2009, private enterprises generated more than half of GDP, created more than 80% of new jobs in cities and urban townships, and supplied 65% of new patents and more than 80% of new products. However, the legal framework for private business continues to be weak, nontransparent and arbitrarily implemented, while foreign business investments remain subject to government restrictions. There is a lack of regulatory reliability, since the relevant rules are frequently altered by central and local governments. Although private enterprises today have an increased ability to enter market sectors which were previously restricted, dominated by state-owned enterprises or heavily regulated (for example public utilities, financial services or national defense), privately owned enterprises still face frequent discrimination. The government's post-2008 anti-crisis stimulus measures have mostly served to prop up big state-owned enterprises (SOEs) to the detriment of private businesses. Since the outbreak of the financial crisis, private companies have found it more difficult to get access to bank credit. Though there has been plenty of available cash on the market, it has been channeled by state banks almost exclusively to SOEs. Repatriation of profits is difficult due to foreign exchange controls and extensive approval and implementation procedures. The informal sector is relatively small, accounting for about 12% of the overall economy in 2007 (the most recent available data).

In August 2008, the new Anti-Monopoly Law (AML) went into force. It prohibits monopoly agreements between competitors, abuse of dominant market position and administrative monopolies. It also aims at tearing down artificial trade barriers within China, and thus at eliminating local protectionism. The Ministry of Commerce, National Development and Reform Commission and State Administration for Industry and Commerce are responsible for implementing the AML. However, due to inconsistent enforcement and implementation, as well as the remaining legal insecurity facing private businesses, full market-based competition is not yet a reality. Furthermore, in some strategic sectors (such as the defense industry, power production, petroleum, gas, petrochemicals, coal, civil aviation and shipping), the state supports existing SOE monopolies.

China's economic development is heavily dependent on trade, and in 2009 China surpassed Germany as the world's largest exporting nation. Since accession to the WTO in 2001, foreign trade has been liberalized continually; direct intervention in trade has decreased, import barriers have been reduced and the average most-favored nation tariff rates were lowered to 9.5% (with an average weighted tariff of

Anti-monopoly  
policy

6

Liberalization of  
foreign trade

8

4.2%) in 2009, with many machinery and material inputs required for manufacturing exempt from tariff. During the period under review, China also entered several regional and bilateral free trade agreements, such as the ASEAN agreement that went into effect on January 1, 2010, and a comprehensive trade agreement with Taiwan (the Economic Cooperation Framework Agreement, or ECFA) in the same year. However, the abolition of export barriers has been slow, and a number of restrictions such as prohibitions, licensing rules and nontransparent tariff classifications remain. Furthermore, regulations meant to improve trade freedom are undermined by corruption and arbitrary administration. As a means of supporting an export industry that was severely hit by the collapse of demand from the United States, the European Union and Japan, Chinese authorities reintroduced ad hoc measures such as interim export taxes and value-added-tax rebates. In the second half of 2010 and in January 2011, Chinese export restrictions on rare earths that are almost exclusively (up to 97%) produced in China prompted international criticism.

The Chinese government has made efforts to improve the foundations of the country's banking system, and to introduce more market mechanisms. All four of the biggest state-owned commercial banks (SOCB) are now listed on stock exchanges, and number among the world's biggest banks with regard to their market capitalization. This has not only brought fresh capital, but also greater transparency due to foreign accounting services' review of these banks' financial reports. In line with WTO commitments, much of the banking sector has been opened to foreign banks, and restrictions on foreign banks' local currency business have been lifted; however, some Western banks that had bought Chinese bank shares were forced to sell them during the financial crisis in order to raise capital. All in all, foreign banks continue to play only a miniscule role within China's banking system, due to the effects of remaining constraints. Furthermore, the banking system is highly concentrated, with the four largest state-owned banks accounting for more than half of the sector's assets. Privatization in the financial sector is not far advanced; most non-bank financial institutions such as life insurance, investment and securities companies are state-owned or controlled by local governments. However, even though the quality of major commercial banks' assets, their profitability and their levels of service diversification remain insufficient, and though CCP interference in state-owned commercial banks' business decisions is a daily routine, the Chinese banking system proved remarkably resilient during the financial crisis. This was in part thanks to the country's closed capital account, which meant that Chinese banks were not exposed to risky Western financial instruments, and therefore required no bailouts by the government. On the other hand, with new credit issuance amounting to \$1.4 trillion in 2009 and about \$1.1 trillion in 2010 as a result of country's anti-crisis measures,

Banking system

6

there is a high probability that the share of nonperforming loans – which were cut to 1.3% of GDP by 2010 in absolute terms – is soon going to rise dramatically.

The financial market is still dominated by commercial banks, and although institutional investors are on the rise, this segment is still in its infancy.

## 8 | Currency and Price Stability

After feeling inflationary pressure in 2007 (inflation rate of 4.8%) and 2008 (5.9%), China experienced a period of deflation in 2009 (-0.7%) as a result of the financial crisis. When deflationary tendencies became obvious in 2009, the government took countermeasures which included lifting controls on food prices, increasing the money supply, expanding financial institutions' total lending, and repeatedly cutting interest rates. With the successful economic rebound of 2010, authorities were again confronted with the need to fight inflation, which hit 5.1% in November (and 3.3% for the year as a whole). To get inflation under control, the government reintroduced price controls, raised interest rates, and raised the required reserve ratios for commercial banks. In 2010, China's trade surplus was \$183.1 billion, its foreign reserves stood at \$2.85 trillion at the end of the year (equivalent to about 50% of the country's GDP and 30% of all global foreign exchange reserves). The government has thus come under continual criticism for bearing part of the responsibility for the global imbalances leading up to the financial crisis. To date, China has resisted U.S. calls to let the yuan appreciate significantly. The flexibility of the yuan is likely to be enhanced in 2011 as a means of helping to rebalance the economy and control inflationary pressures. The central bank is not independent, but is rather under tight control of the central government, which sees the financial system as an important instrument in steering the economy.

Anti-inflation /  
forex policy

6

Macroeconomic stability is of utmost importance to the Chinese government. From 2003 to 2007, the government achieved double-digit economic growth. With GDP growing at 9.6% (2008), 9.2% (2009) and 10.3% (2010), China weathered the financial crisis like no other large economy. This was in part due to a \$586 billion stimulus program that jumpstarted the Chinese economy, focusing mainly on massive infrastructure investments. The main problem is that China's economy, particularly after the 2009 and 2010 anti-crisis measures, is much too dependent on fixed-asset investment (accounting for 47% of GDP) and exports, with domestic consumption still lagging considerably behind. With overall public spending around 30% of GDP, a small budget deficit (less than 3% in 2009), little gross national debt (about 20% of GDP in 2009) and \$2.85 trillion in foreign exchange reserves as of the end of 2010, China has been able to afford such drastic increases in expenditure. Chinese authorities face the challenge of maintaining annual growth rates of at least

Macrostability

8

8% in order to guarantee a sufficient supply of jobs and thus avoid social unrest, while at the same time rebalancing the economy toward a more sustainable consumer-driven development path.

## 9 | Private Property

In October 2007, China's first private property rights law came into force. The law "protects the lawful property of individuals," thus, the property rights of private businesses, home buyers, car-owners and the like. It also aims at protecting state-owned assets, and prohibits the illegal possession, destruction or looting of state property by private persons. However, the implementation and enforcement of these formal regulations is inconsistent and arbitrary due to the weakness of the judiciary and corruption in administrative agencies. Disregard for intellectual property rights, theft of technology, and the production and sale of counterfeit goods are widespread and inconsistently prosecuted. All land ownership remains with the state, meaning that peasants do not have secure property rights. In late 2008, the CCP decided to allow peasants to lease their contracted farmland or transfer their land-use rights for a fair price when they migrate to urban areas. This rule also gives farmers the possibility of merging plots and employing modern farming technologies on larger fields, thereby increasing productivity and incomes. Since ultimate control over the land remains with local party functionaries, the rule provides no safeguard against illegal land seizures by corrupt officials. According to estimates, up to 40 million peasants have already lost their land use rights this way and are now landless.

Property rights  
6

Private enterprises increasingly form the backbone of the Chinese economy; by the end of 2009, private enterprises generated more than half of GDP, created more than 80% of new jobs in cities and urban townships, and supplied 65% of new patents and more than 80% of the country's new products. Although private enterprises also benefit from the private property rights law, some stumbling blocks remain, such as difficulty in gaining access to capital, licensing procedures marked by long delays and a lack of transparency, local government favoritism, and pressures to pay illegal fees. In 2009 and 2010, a new trend emerged of private enterprises (typically small steel smelters or coal mines) being closed down by local authorities or taken over by state-owned competitors under the pretext of environmental or workplace-safety concerns. It remains to be seen whether this is just a passing phenomenon or a fundamental shift aimed at driving private enterprises out of business.

Private enterprise  
6

The transformation of SOEs into public corporations under diverse forms of ownership continues, albeit slowly. In 2010, the central state controlled 122 SOEs in key industrial sectors; considerably more than the 80 to 100 that had been envisaged for this year. The country's anti-crisis measures led to a resurgence in the role of the state in the economy, as most of the stimulus money was provided by



state-owned banks to state-owned construction companies in charge of infrastructure projects. Most SOEs now are profitable. In 2007, the central government began to require SOEs to provide dividends; in January 2011, these were increased, depending on individual enterprise's industry. In many cases, post-tax profits are not due to the efficiency of SOEs, but are instead derived from a monopolistic market position gained in the process of restructuring. Since these monopolists are often found in industries which produce goods for public consumption, this situation frequently results in unnecessary high costs for consumers.

## 10 | Welfare Regime

Basic public social security systems covering pensions, health care, unemployment, accidents and maternal care are in place in China, but are largely targeted at the urban population. For example, the current unemployment insurance program covers employees of urban enterprises and institutional organizations, but not farmers. One serious problem is the social security of migrant workers, since many employers do not pay the necessary premiums for migrant workers, though obliged to do so by law. Similarly, the large number of individuals employed in the informal sector suffers from inadequate coverage for social risks. In rural areas, cooperative medical systems established in 2003 have largely broken down, leaving more than 90% of the rural population with no health insurance.

All in all, according to official statistics in 2009, 235 million people were enrolled in basic pension programs, 127 million urban residents were included in unemployment insurance programs, and 400 million were covered by basic health care insurance. In addition to the institutional insufficiency of the existing systems, prevalent corruption further undermines social security. Since hospitals and doctors charge arbitrary fees and often insist on bribes, there is a high degree of uncertainty as what costs for health care and other risks can be expected. The inadequacy of the public social security system is a primary reason for the population's extremely high savings rate, which in turn undermines government efforts to increase national consumption as a proportion of GDP. In the context of the financial crisis, the central government was able to push ahead in April 2009 with a new health care reform blueprint that will contribute an additional sum of CNY 850 billion (\$124 billion) to basic health care by 2011.

There is good access to education, social security systems and public services in urban coastal regions, and the Chinese government has made considerable efforts in recent years to ensure that basic services are also available in the countryside, western provinces and ethnic minority regions. Due to Chinese parents' preference for male offspring, a sharply unbalanced male-female birth ratio of 1.21 was seen between the years 2000 and 2005 (for the 1990 – 1995 period, the rate was 1.15;

Social safety nets

5

Equal opportunity

5

internationally, this ratio is usually about 1.05) There remains a gender gap in adult literacy; at the end of 2007, 96.5% of men and 90% of women were literate. In 2007, there was a gap between the average annual female income of \$4,323 (in purchasing power parity (PPP) terms) and average male income of \$6,375 (also in PPP). Children who follow their migrant worker parents to the cities face great difficulties in accessing educational institutions, since their parents are often unable to pay the extra fees charged for migrant-worker children. Girls and women are still often denied equal access to health care, education, political participation and economic opportunities. Regarding political participation, women hold 21.3% of parliamentary seats and 9% of ministerial positions. Economic exclusion of and social discrimination against ethnic, religious and linguistic minorities in mainstream society continue.

## 11 | Economic Performance

Macroeconomic performance in China continued to be strong during the review period, in spite of the ripples resulting from the global financial crisis. The Chinese economy maintained very high annual growth rates of 9.6%, 9.2% and 10.3% respectively from 2008 to 2010. Inflation reached 5.9% in 2008, 0.7% in 2009 and 3.3% in 2010. GDP per capita was \$4,415 (at market exchange rates, 2010). The official rate for urban unemployment was 4.1% (2010); however, the RAND Corporation estimates total unemployment to be higher than 20%. In 2009, government revenue was CNY 6.85 trillion (\$1 trillion), tax revenues amounted to CNY 5.95 trillion (\$871 billion), the overall budgetary deficit was 3.0%, and the gross government debt stood at 18.6% of GDP. The total value of 2010 imports and exports was \$2.973 trillion, while the country's trade surplus was \$183.1 billion. Realized incoming FDI was \$105.7 billion, and outbound nonfinancial FDI amounted to \$59 billion (2010).

China's impressive economic performance during the financial crisis was founded on a massive CNY 4 trillion (\$586 billion) stimulus plan, which – amounting to 13.3% of China's 2008 GDP – was the biggest such stimulus package among all major economies. By investing in massive infrastructure projects, and social as well as industrial policy programs, China was able to compensate for the drop in exports in 2009.

## 12 | Sustainability

In 2007 (the most recent available data), China became the world's most substantial producer of CO<sub>2</sub>, accounting for one-fifth of global carbon dioxide emissions. In the face of severe environmental degradation and its negative impact on economic development and social stability, the Chinese government has put a new focus on

Output strength  
10

Environmental  
policy  
5

sustainable development. As part of the country's "scientific development" concept, this is enshrined in the party statute and is reflected in the 12th Five Year Plan (2011 – 2015). Chinese authorities claimed in January 2011 that they had reached their aim of cutting energy consumption per unit of GDP by 20% between 2005 until 2010. In November 2009, China pledged to reduce carbon dioxide emissions per unit of GDP by 40% to 45% by 2020, as compared to 2005 levels. There are a number of laws in place dealing with lean production, energy saving, renewable energy and similar issues, so environmental concerns are enshrined in the institutional framework. However, implementation of environmental policies remains seriously inadequate. Resistance by industries and local governments leads national environmental regulations to be routinely violated, and efforts to establish a "green GDP" concept were abandoned in 2007. The State Environmental Protection Agency, which was upgraded to ministerial status in March 2008 in order to give it more clout in implementing national environmental policies, was largely sidelined during China's anti-crisis stimulus measures in 2009 and 2010.

Spending on R&D as a percentage of GDP has risen from 0.6% (1995) to 1.49% (2008), and the government is optimistic of reaching 2% by the end of 2010. R&D is heavily driven by foreign companies' investments, and is dispersed very unevenly across the country, with high R&D intensity concentrated in Beijing, Shanghai, Shaanxi and Sichuan. The number of applications for new patents has also increased substantially, with China expected to pass Japan, the current leader, by 2012.

Expenditure on education accounted for 3.48% of GDP in 2010 and is projected to rise to 4% in 2012 according to the Medium and Long-term National Educational Reform and Development Plan (2010 – 2020). In 2010, the education budget was increased to CNY 216 billion (\$32.1 billion). Since past funding has been distributed unevenly across regions and institutions, favoring urban and coastal regions and tertiary institutions, the government has recently focused on rural areas.

Education policy /  
R&D  
8

## Transformation Management

### I. Level of Difficulty

Structural constraints in China are generally on the rise. Environmental degradation poses serious risks to the foundations of development. Natural disasters (severe floods, droughts, etc.) regularly hit China, leading to considerable economic losses. In April 2010, a major earthquake shattered Yushu county (Qinghai province), an ethnic-Tibetan majority region, causing 2700 deaths. China's dependence on trade and export markets poses considerable risks. The global financial crisis hit China in late 2008; the subsequent collapse of demand for Chinese goods from the United States, Europe and Japan led to the closure of thousands of export-oriented factories, especially in southern China. As a result, about 20 million people, most of them unskilled migrant workers, lost their jobs. With the majority of these individuals returning to their home provinces, there was considerable danger of public unrest. Authorities were able to defuse these dangers with their successful \$586 billion stimulus plan, as laid-off workers quickly found new jobs in massive infrastructure projects. However, deep regional developmental inequalities and the large population of unskilled migrant workers endanger social stability and constrain effective governance.

Structural  
constraints  
6

While social trust is relatively high, there is no robust tradition of civil society in China. NGOs and voluntary organizations have emerged only recently. Since the state controls and intrudes in the work of these organizations, and many of them remain rather particularistic in their orientation, NGOs and voluntary organizations are not in a position to provide channels for popular participation or the representation of social interests. Consequently, uncontrolled, often violent local eruptions of social unrest (so-called mass incidents) driven by discontent with pollution, housing demolition and relocation, or expropriation of rural land have numbered between 80,000 and 100,000 in the last few years.

Civil society  
traditions  
9

While there are no irreconcilable ethnic, social or religious cleavages in the PRC, social unrest intensified during the review period. Economic development has proceeded in a highly inequitable manner – a fact indicated by the widening wealth gaps or the unequal access to health care and education, among other signs – contributing to the fragmentation of society into a small well-off segment and a

Conflict intensity  
5

large group that does not benefit proportionately from economic development. This has increasingly led to violent eruptions of social conflict, which have in turn been followed by harsh state reactions. After the outbreak of violent protests in Tibet in March 2008 and Xinjiang in 2009, the situation in both autonomous regions has become more tense. With a growing proportion of Tibetans and Uyghurs striving for genuine autonomy, and the central government's position hardening, prospects for compromise between the two sides have become increasingly remote. In 2010, widespread labor strikes took place in southern China (mainly directed against Taiwanese and Japanese investors), focusing on dismal working conditions and low minimum wages. Foreign companies promptly reacted by raising minimum wages substantially.

## II. Management Performance

### 14 | Steering Capability

The Chinese government pursues social stability and economic development as its two main priorities. It has sought to improve social harmony and stability by increasing investment in rural health care and education, increasing transparency in government, broadening elections for party officials at local levels, abolishing agricultural taxes, creating a dedicated policy to develop the western provinces, and attempting to increase judicial fairness (through stopping short of making the judiciary politically independent). All these policies are designed to mollify public discontent, and have been paralleled by a reliance on the internal security apparatus. The Chinese leadership does not aim to engage in any meaningful process of political reform or regime democratization.

In contrast to its often repeated determination since 2003 to turn away from “at all costs” economic growth, and to embark upon a sustainable development path, the global financial crisis forced the Chinese leadership to focus solely on propping up the economy (“defending 8% growth”). To do so, the Hu-Wen administration drastically increased public spending for infrastructure and social policy programs in 2009 – 2010, seeking to allow domestic consumption to make up for losses experienced by export industries. China successfully overcame the effects of the financial crisis; however, the risks posed by a rising inflation rate, a growing property market bubble and overinvestment in fixed assets led the government in the second half of 2010 to again stress the need for a more balanced sustainable growth pattern, and to make controlling inflation a top priority.

Question  
Score

Prioritization  
5

Overall, the government has effectively been able to implement its main political priorities of protecting social stability and economic growth, even though this has come at the expense of civil liberties. Authorities at the central, provincial and local levels were extremely successful in 2009 and 2010 in fighting the financial crisis, as measured by their ability to keep up growth, minimize unemployment and (generally speaking) uphold social stability. It is remarkable how quickly and fully the government was able to shift priorities, from efforts to fight inflation and economic overheating that lasted well into 2008, to addressing the financial crisis beginning in autumn 2008. The key to jump-starting the economy was the authorities' reliance on the hierarchical channels of the Communist Party, and the reactivation of investment planning procedures dating from the command economy era. While on the whole, central government policy initiatives in non-crisis times are often compromised by the autonomy of local officials in a highly decentralized political system, central and local authorities were united in efforts to uphold growth and avoid unemployment during the implementation of the anti-crisis stimulus plan in 2009 and 2010. During the review period, the Chinese leadership did not intend nor attempt to implement any political reforms aimed at regime democratization.

Implementation  
5

China's leadership demonstrates the ability and the willingness to learn from past experiences and new sources of knowledge. However, this willingness is confined to social and economic policies, and does not extend to political reforms. In recent years, the leadership has acknowledged that the past focus on uncontrolled economic development has brought about social conflict, human hardship and ecological deterioration. It is remarkable that the Chinese stimulus plan, unlike those of other countries, included long-term social policies, measures for sustainable development, and industrial policies aimed at technological innovation and structural adjustment. Obviously, the leadership identified the crisis as a window of opportunity to make progress in these areas. President Hu Jintao's emphases on increasing social equality and justice and on strengthening sustainable development are now part of the party constitution, and play an important role in the 12th Five Year Plan (2011 – 2015). However, these reforms face strong opposition on the part of special interests that benefit from unequal access to resources and influential decision-makers, and thus seek to hamper the implementation of reform measures. China's leadership is not ready to accept that more pluralism and democratic reforms such as increased transparency, media freedom and public participation are required as a safeguard against this sort of undue influence and corruption.

Policy learning  
5

## 15 | Resource Efficiency

Resources are not used efficiently in the areas of civil service personnel, budget resources and public administration organization, although there has been continuous improvement. As of 2007, China had more than 12 million employees in state, CCP and mass organizations, as well as about 10 million civil servants, a considerable increase in the size of the civil service bureaucracy as compared to the 1980s and 1990s. The quality of the civil service has improved; meritocratic hiring procedures through competitive examinations as well as task-related performance appraisals have been introduced, and the vast majority of civil servants today hold university degrees. However, bureaucratic professionalism and efficiency is systematically undermined by rampant corruption and the overarching power of the CPP. Through its nomenclature system, the party influences appointments to the upper levels of government and party bureaucracies, putting party loyalty and support for present leaders before professional competence.

Efficient use of  
assets

5

China's budgetary system is highly decentralized, with local governments responsible for almost 70% of total government expenditures. The central government takes in over half of all revenues, and shares them with the provinces at its discretion. Given the lack of transparency and accountability, fiscal resources are distributed not according to a common and equitably implemented scheme, but according to provincial leaders' political weight and negotiating skills. The central government seems to profit from this arrangement, though the government deficit jumped in 2009 to CNY 740 billion (\$108 billion or 2.2% of GDP) from CNY 128 billion (\$18.4 billion or 0.4% of GDP) in 2008. This deficit reflects the government's determination to fight the financial crisis, and is low compared with other countries.

The Chinese government often has difficulty reconciling conflicting policy objectives and interests due to a lack of coordination and persistent friction between the national and regional/local administrative levels. This tension results from differing incentives on the central and the local level. The central government attempts to prioritize sustainable and equitable growth, while local governments undermine this policy by fuelling excess development in their localities in order to expand employment opportunities and revenues, from which local administrative bodies gain individual political and economical profit. However, as shown in the reaction to the international financial crisis, the government can increase coordination if it strengthens oversight mechanisms and if the interests of the local and central levels converge. Whereas in 2007, the central government faced enormous difficulties in reining in excessive growth and controlling inflation due to local resistance, in implementing the anti-crisis stimulus measures the central government and the local authorities fought side by side, united in the aim of

Policy  
coordination

6

propping up the economy. Regular inspection tours by high-ranking CCP Politburo members, National Audit Office representatives and officials from the National Development and Reform Commission were used to ensure that implementation of the stimulus projects was taking place as planned.

Governmental and CCP anti-corruption work is mainly limited to mass campaigns and moral exhortations, and has proven largely unsuccessful. Individual high-profile corruption cases in which long prison terms or even death sentences are imposed are widely publicized, designed to act as deterrents and to serve as evidence of the government's determination to eradicate corruption. However, only low-level, small-scale corruption has decreased, while the prevalence of high-level, large-scale corruption continues to rise. The lack of competitive political processes, institutional checks and balances, accountability mechanisms, an independent judiciary, and a free press increase the regime's susceptibility to corruption, while the involvement of high-ranking political figures in corrupt practices reduces incentives for the implementation of serious anti-corruption measures. Corrupt officials and cadres increasingly collaborate with local organized criminal groups.

Anti-corruption  
policy  
4

## 16 | Consensus-Building

There is broad consensus among Chinese leaders and the public that maintenance of national sovereignty, territorial integrity and international prestige should be key national goals. Similarly, there is agreement that this goal should be reached both through economic and mainly market-driven development and the strengthening of China's military force. However, the concrete concept and goal of economic development is still contentious, and the CCP leadership does not unanimously favor the implementation of a full-fledged market economy with socio-political safeguards. Since 2007, President Hu's "scientific development" concept has been part of the Communist Party constitution. Although his "socialist harmonious society" doctrine calling for more sustainable and socially just development did not get full party approval at that time, important parts of it are reflected in the 12th Five Year Plan (2011 – 2015). In any case, conflicts as to the appropriate focus for future socioeconomic development persist, and the Hu leadership has had to compromise with intraparty opposition in some cases. Regarding political development, however, there is a strong consensus within the leadership opposing any democratic reforms.

Consensus on goals  
7

Since the late 1980s, the party leadership has been united in its opposition to opening the political system and to truly democratic reforms. During the review period, Premier Wen Jiabao has repeatedly called for greater accountability and a strengthening of the rule of law, but the extent to which this reflects an actual focus on reform rather than simply a public-relations strategy aimed at improving the government's image remains unclear. In any case, Wen has been an isolated voice

Anti-democratic  
actors  
2



on this issue, and his calls did not result in the emergence of democratic change agents during the review period.

Two decades of unconstrained economic development have resulted in serious social distortions and conflict between those segments of the populace with access to education, health care, social security, adequate incomes and living conditions and those without. Violent eruptions by groups of disadvantaged citizens have proliferated dramatically, and Chinese society is in danger of falling apart along those social fault lines. The Chinese government acknowledges the importance of equal opportunity and social justice in maintaining the nation's stability (and the CCP's hold on power), and has therefore made it a priority to spread the fruits of economic development more evenly. However, the 2009 and 2010 stimulus measures have done nothing – at least in the short term – to substantiate this political program in any sustained way.

Cleavage /  
conflict  
management

6

The political decision-making process is dominated by internal debates between the CCP and state organs. In recent years, the party and government have integrated expert advice by think tanks and individual academics into the formulation of policy, and since 2000, the government has tried to strengthen citizen input into policy-making by holding public hearings on pending national legislation. Today, developments of general concern such as health care, education and especially environmental problems and corruption are discussed more broadly in society – not least via the Internet. Nevertheless, public opinion still has little ability to influence political decision-making, and even what limited opportunities for participation and discourse exist are strongly regulated, monitored and controlled by state and party organs. In cases when public debates become too explicitly critical of political processes or developments, the debates are suppressed, and individuals leading the debates can face harassment and even prosecution.

Civil society  
participation

3

The Chinese government regularly evokes collective memories of past injustices suffered at the hands of Western or Japanese “imperialist aggression” in order to strengthen national unity and garner support for its political goals of national development. Concerning its own past, however, it strictly prohibits all public discourse about human rights violations, and does not acknowledge the CCP's responsibility for past injustices. During the 20th anniversary of the 1989 Tiananmen massacre, for instance, state control over the Internet was severely tightened, and monitoring and harassment of opposition groups and individual activists was intensified.

Reconciliation

4

## 17 | International Cooperation

China maintains and has expanded cooperative ties with multilateral institutions such as the IMF, the World Bank and the Asian Development Bank (ADB), as well as with foreign governments, in order to obtain support for ongoing economic reforms. Some nations, including Japan and Germany, have cancelled financial assistance to China and concentrate instead on technical cooperation, focusing mainly on the transfer of “green” technologies, sustainable development practices, health care tools, social security models and legal reforms. China makes efficient use of this support, particularly in areas where it is technologically backward, such as renewable energy sources and energy conservation. However, such assistance is exclusively concerned with social and economic reforms. The government does not allow any international interference with what it terms “internal affairs,” especially in issues such as democratic reform, adherence to human rights standards and the solution of the Taiwan question.

Effective use of support

7

In recent years, China has increased its efforts to be considered a reliable member of the international community and a dependable partner in bilateral relations. However, this is exclusively limited to economic issues. In 2009 and 2010, China was widely acclaimed for its role in fighting the global financial crisis. Its demand for commodities, capital and consumer goods made it a vital trading partner for a variety of countries (e.g., Australia, Brazil, Germany, South Korea). At the same time, traditional sources of conflict with the West have persisted, and in some cases even intensified. Both the United States and the European Union still complain about their trade deficits with China (USA 2009: \$227 billion; EU 2009: €128 billion), restrictions in market access, rampant violations of intellectual property rights, China’s hunger for resources, its drastically increasing emissions of greenhouse gases, export restrictions (particularly on rare earths), and cyber-attacks on government networks. The United States has persistently criticized the undervaluation of the Chinese yuan and Beijing’s hoarding of foreign exchange reserves, and is increasingly worried about China’s growing financial influence due to its accumulation of U.S. Treasury bonds. The Chinese government is not considered reliable in terms of political reforms, including on the issues of guaranteeing human rights or engaging in democratic opening. It does not shy from alienating the global community through repression of its own people, as demonstrated by its crackdowns on the Tibet and Uyghur revolts, and its harsh reaction to the 2010 Nobel Peace Prize being awarded to dissenter Liu Xiaobo.

Credibility

8

In 2009 and 2010, economic cooperation between the People’s Republic of China and other Asian nations deepened substantially. The China-ASEAN Free Trade Area came into effect on January 1, 2010, and China is now the most important trading partner for Japan, South Korea, Australia, New Zealand and many ASEAN

Regional cooperation

8

countries. Also in 2010, a quasi-free trade agreement (ECFA) was reached with Taiwan, which has reduced limitations on cross-strait trade. In spite of these booming trade and investment relations, traditional security concerns about China's role in the region have deepened. After North Korea sank a South Korean warship and shelled a South Korean island in 2010, South Korea and the United States criticized China for not doing enough to stop the Kim Jong-il regime. Conflict with Japan over the Senkaku/Diaoyu islands gained prominence after a collision between a Chinese trawler and a Japanese patrol boat, and has put a huge strain on relations between the two states. Furthermore, China's military has continued its ambitious program of military modernization, with official defense budgets rising 14.9% in 2009 and a projected 7.5% in 2010. As a result of its rising economic and military clout, China seems to many observers in the region and beyond to have discarded its soft-power-based "charm offensive" in favor of a more assertive approach. This has led to an increasing number of Southeast Asian countries seeking closer security relations with the United States, while the latter has proclaimed that defending the freedom of the sea lanes falls into its national interests. Concerning Taiwan, in spite of the thaw in cross-strait relations since 2008, China has not abandoned its uncompromising stance concerning the island's international status, and has only partly been prepared to compromise on the "one China principle." However, China has been ready to go back to the so-called 1992 consensus, which states that there is only one China, but both sides differ in what it is. For the time being, this has formed the core of a *modus vivendi* between the Chinese Communist Party and Taiwan's KMT.

## Strategic Outlook

During the review period, economic development and transformation progressed rapidly, but severe structural problems and risks persisted. In quantitative terms, China's stimulus plan helped its economy weather the global financial crisis, and the country's importance in the world economy further increased. At the same time, the anti-crisis measures deepened China's dependence on fixed-asset investment as the main driver of growth. Domestic consumption as a proportion of GDP, which is vital for sustained growth, still lags. Therefore, beyond the short-term stimulus measures, the leadership will need to strengthen broad-based domestic consumption in a sustainable manner in order to stabilize the economy in coming years. In particular, citizens' incomes must be increased. Since excess private saving is mainly induced by citizens' need to build up financial reserves for risks such as illness and unemployment which are not (sufficiently) covered by social security schemes, social safety nets must be expanded. Growth must also take sustainability and energy efficiency into consideration, since China's status as the world's biggest emitter of greenhouse gases and its evident lack of will to cooperate with developed nations on this problem have increased international tensions. At home, ecological damages brought about by two decades of supercharged economic development pose a severe challenge to sustainable economic and social development. Developed nations should work hard to integrate China tightly into global regimes on these issues, and to exact substantial commitments from the Chinese government. Ongoing commercial and noncommercial transfers of "green technology" to China will be essential in the deceleration of ecological degradation.

Social development also faces severe challenges. Increasing disparities in the distribution of wealth and opportunities have led to social tensions and violent unrest. The Chinese government must not only adopt measures that promote a more equitable distribution of wealth, but also allow for legitimate and accountable channels through which people can seek redress. Thus, nascent elements of civil society such as NGOs, self-help groups and lawyer-activists supporting the disadvantaged should not be suppressed and intimidated; indeed, their input should rather be accepted by the government as a means of enhancing participation and feedback. Foreign NGOs can help by providing financial and operational support as a way to strengthen their Chinese counterparts.

In order to successfully manage the short-term problems related to the financial crisis as well as structural reforms further down the road, the Chinese government needs a high level of steering capacity. However, rampant corruption and local governmental arbitrariness are eroding the government's authority and legitimacy, and also threaten the efficient implementation of efforts to rebalance the economy. Since mechanisms such as a free press and an independent judiciary are indispensable for successfully controlling arbitrary officials and corruption, foreign governments should be less shy in explicitly demanding reforms in this area. The necessary support measures should be included as a part of governmental and private development cooperation efforts. In addition to dealing with economic crisis and transformation, the most

difficult challenges in China's future will lie in managing political and societal change; thus, foreign governments and economic actors should not focus exclusively on economic aspects when dealing with the PRC, but should consistently address political and social issues, and offer adequate support in these areas as well.