

BTI 2016 | China Country Report

Status Index	1-10	4.95	# 84 of 129	
Political Transformation	1-10	3.28	# 111 of 129	➔
Economic Transformation	1-10	6.61	# 32 of 129	➔
Management Index	1-10	4.73	# 75 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	1364.3	HDI	0.719	GDP p.c., PPP \$	13216.5
Pop. growth ¹	% p.a.	0.5	HDI rank of 187	91	Gini Index	42.1
Life expectancy	years	75.4	UN Education Index	0.610	Poverty ³	27.2
Urban population	%	54.4	Gender inequality ²	0.202	Aid per capita \$	-0.5

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

Executive Summary

During the review period, China exhibited an unusual mixture of financial and economic reform, political retrenchment and assertiveness in foreign relations. Two task forces were formed at the third plenum of the 18th Central Committee: one for economic reform, and the other for national security, with Xi Jinping in charge of both.

China's economy is facing major challenges and the government is continuing to address them. It has further liberalized the banking sector. Banks are now more flexible in setting deposit and interest rates, restrictions on interbank lending have been relaxed, and a greater number of private banks are entering the market. It is hoped that these measures will invigorate the banking sector. The yuan's peg with the dollar has been loosened somewhat by increasing its daily trading band from 1-2%, while the yuan's conversion on capital accounts has been made easier, a further step towards making the yuan a more international currency. In an attempt to enhance linkages between the stock exchanges in Shanghai and Hong Kong, Hongkongers can now freely buy and sell yuan. In order to address the problem of mounting liabilities in China's local governments and unfunded mandates, some cities have been allowed to issue bonds. On the other hand, the central government has announced that it will no longer bail out bankrupt localities.

Other reforms conducted during the review period targeted the structural transformation of China from the workbench of the world to a knowledge-based economy by softening the one-child policy, relaxing hukou restrictions and pushing forward with urbanization. Indeed, the latter two reforms are linked: the rural population is being lured to small cities – many of which are not yet built – with the promise of easy access to permanent residency. In contrast, China's megacities will be off limits for migrants in the future. It is hoped that spreading cities evenly throughout China will reduce pressure on natural resources in megacities and enhance domestic consumption by diluting existing markets.

Domestic politics has been marked by renewed centralization and the concentration of power in the person of Xi Jinping. On the one hand, the continuing anti-corruption campaign has targeted political opponents, most notably the former head of the security apparatus Zhou Yongkang and the former vice chairman of the Central Military Commission Xu Caihou. On the other hand, the campaign has swept through the ranks of politicians and administrators at all levels and all sectors of the state, including the party, government, SOEs, the military and universities. In addition, the freedom of journalists and teachers has been further restricted: both groups are subjected to ideological indoctrination and must answer for a lack of patriotic fervor. Although rule of law was strengthened at the fourth plenary session, this only applies to legal procedures – it has been made clear that the CCP, as an organization, will remain above the law.

With regard to foreign affairs, China has continued its military buildup, while conflicts in the South China Sea and East China Sea have intensified during the review period. For example, China has unilaterally declared an “air defense identification zone” in the East China Sea, and close encounters between Chinese fighter planes and military planes from both the U.S. and Japan have created concern that tensions may escalate and ultimately lead to war in the region. This provocative behavior was accompanied by more aggressive rhetoric (e.g. calls from within China for a “great power diplomacy with Chinese characteristics”), causing observers to ask whether China has reneged on its long-standing foreign policy of “peace and development.”

On a positive note, China and the U.S. agreed on measures to reduce carbon emissions and China has courted emerging economies and less developed countries with new initiatives to strengthen regional as well as global cooperation.

History and Characteristics of Transformation

Economic transformation in China was initiated through the “Opening and Reform” policy introduced in 1978. After the upheaval of the Cultural Revolution, the Chinese leadership emphasized economic and political consolidation. Despite initial structural deficiencies and distortions, 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 the government expropriated land at low or no compensation, which further served to keep factor costs low. Despite the existence of a planned economy, the public sector remained rather limited. Overseas Chinese from Hong Kong and Taiwan were eager to provide scarce capital and managerial know-how as soon as the Chinese leadership decided to experiment with foreign direct investment. These specific circumstances considerably facilitated economic development.

Consensus among the leadership to determinedly follow the Opening and Reform policy drove economic reforms. However, since the Tiananmen massacre in 1989 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 competition or even initialize a transition to liberal

democracy. In the aftermath of the “incident,” which remains a taboo topic in China, political reformers were purged from the CCP leadership and since then, party and state elites have been united in their commitment to limit reforms to the economic area and allow political reforms only in the administrative sector, enhancing governance, but not democracy.

Economic reforms and decentralization during the same period have proceeded gradually and been subject to experimentation. In this way, China has avoided the transformational “shocks” that occurred in the Russian Federation, for example. Absent a detailed roadmap, the Chinese leadership allowed for reform initiatives from lower administrative levels to be implemented locally and by way of trial-and-error. If successful, these local initiatives were adopted as national policies. The leadership’s decision to let a planned economy and the gradually emerging private sector coexist has proven most important in maintaining economic stability. 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 GDP growth rates of about 10% from 1978 to 2010 and, with the exception of two spikes in 1988 and 1989 (18%) and 1994 and 1995 (24%), relatively low levels of inflation. Growth rates have declined after the global financial crisis from 2008 to 2010 and the ensuing global recession. Living standards have improved significantly, and the number of absolute poor has decreased by 300 million from 1978. This overall success is clouded by the increasingly uneven spread of wealth. Urban incomes today are more than three times those of rural incomes, and the Gini index (officially 0.474, by some measures even as high as 0.61) reveals that, even by the standards of other emerging markets (for example, countries in Latin America or South Africa), China now has one of the most unequal societies in the world.

Rampant corruption, a semi-functional legal system, and a lack of sustainability in economic development constitute other serious problems. The deterioration of the environment is causing enormous economic and social costs and constrains further development. In addition, the Chinese government is increasingly under pressure to fulfill the demands of the population for better public goods (reliable social security, health care and pension systems, a working infrastructure), affordable housing, career opportunities and a more accountable government. There have been increasing numbers of cases of social unrest by people who, devoid of access to institutionalized channels to express their grievances, resort to riots and violent clashes with authorities to make their case. Middle class intellectuals also routinely voice skepticism about regime policies on the Internet.

The current leadership headed by CCP General Secretary Xi Jinping (chosen at the 18th Party congress in November 2012) seems determined to stick to the overall policy line as set by its predecessor: no longer to concentrate exclusively on economic growth but also to take the often negative social consequences of economic development into consideration. While some changes in policy style have been notable in the immediate aftermath of the party congress, there are no signs at all that the new leadership has any intentions to engage in meaningful political liberalization.

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

Transformation Status

I. Political Transformation

1 | Stateness

There is certainty about the nation's existence as a state and, with the exception of secessionist movements in the autonomous regions Tibet and Xinjiang, virtually no competition with the state's monopoly on the use of force.

According to the Chinese constitution, China is a unitary, multiethnic state. Most citizens seem to accept and support the People's Republic of China as a legitimate sovereign nation state. Minority rights in self-governance and representation, economic autonomy, educational autonomy, religious freedom, cultural expression, language use and freedom from discrimination are guaranteed by law. In practice, however, enforcement of the law is very uneven and this has led to considerable pressure from Tibetan and Uyghur secessionist movements, which have become more and more frustrated with their lack of effective political and cultural minority rights and equal opportunities in economic life. Violent mass uprisings, such as in March 2008 (Tibet) and July 2009 (Xinjiang), were prevented in the review period by a massive deployment of security forces to the regions. However, the number of Tibetans who have self-immolated in protest (2013: 27; 2014: 11) has shown the degree of continuing dissatisfaction with the current situation.

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 yet strictly controlled. With the proceeding erosion of communist ideology as well as traditional Chinese family values, people yearn for spirituality. Thus, all kinds of religion, including folk religion and ancestor worship, attract more and more adherents. The government is tolerant of the revival of these various forms of religion in the belief that it will foster social cohesion. Especially noteworthy is the spread of Christianity with an estimated 80 million followers, many of whom congregate in illegal house churches. House churches face occasional harassment.

Question
Score

Monopoly on the
use of force
9

State identity
8

No interference of
religious dogmas
10

In China, a fundamental and sufficiently differentiated bureaucratic structure extends over the entire territory. In a few rural areas, however, the public infrastructure is still weak and access to basic utilities remains inadequate. Furthermore, priority conflicts among different layers of the administration exist. As each administrative unit controls only the next lower level, it is difficult for the central government to ensure that national policies in need of contextualization are implemented correctly at the city, county and township levels.

Basic
administration
8

2 | Political Participation

National level authorities are not selected by free and competitive general elections but are generally chosen by the Organization Department of the Chinese Communist Party. Indirect elections, in which People's Congresses elect the congresses at the next higher level, and the National People's Congress elects the leaders of the executive, merely serve as a procedural legitimization. At the local level, limited venues for participation, such as elections for village and urban residents' committees as well as village leaders and party branch secretaries, and experiments with primaries and elections for township-level legislatures and party secretaries exist. However, these are not designed as democratic experiments but as instruments to make governance in a one-party system more effective. The nomination of candidates, voter eligibility and election campaigns are still subject to local government and party control and manipulation.

Free and fair
elections
1

The political authorities have the effective power to govern and are not overruled by veto powers. The military is under control of the civilian party leadership. However, rulers at the central level are not democratically elected – the elections that do take place are a facade. 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 guaranteed by the constitution, the state often interferes with this right. The number of registered civil society organizations in China has increased from 153,322 (2000) to 499,268 (2012), but these organizations are not allowed to operate independently; instead, they need to find a governmental host organization and then subject themselves to demanding procedures to obtain registration with the Ministry of Civil Affairs or its local counterparts. This severely restricts their autonomy. Political organizations competing with the CCP, for example, "opposition parties" such as the China Democratic Party, are prohibited. Since the government fears that stronger NGOs could limit state control over society, only NGOs with a non-political agenda are tolerated and even supported by the regime. Such NGOs can help the government to shoulder responsibilities such as emergency relief after natural disasters, or provide social services where the adverse effects of economic development have negatively

Association /
assembly rights
2

affected people's lives (such as issues of environmental protection; health care/AIDS; support for the disabled and orphans). Supporting such NGOs is an element of the new strategy of "social management" and is especially welcome where governmental agencies lack the funds and/or the will to provide relief themselves.

Although guaranteed by the constitution, freedom of expression is still severely curtailed. Still, Chinese citizens increasingly make use of the Internet, social media and other mass communication technologies to express critical views, raise public awareness and criticize government actions. The government reacts to this challenge with tightening controls on these technologies, for example by shutting down critical websites, blocking text-message services and censoring online content. Moreover, the email and phone communications of political activists are monitored, as is allegedly the Chinese version of online telephony company Skype. This has resulted in the detention of several "bloggers" and "cyber-dissidents." Most television, radio and print media are controlled and/or owned by state organs. The work of journalists is heavily censored by the CCP, earning China rank 175 out of 178 countries according to Reporters without Borders (2013). Generally speaking, official news reporting meets with widespread suspicion by the population. Some (state-owned) media outlets follow a market logic by proclaiming nationalist content (e.g., in China's island disputes with its neighbors) even if this is not in sync with official policy positions. Foreign media companies also face frequent discrimination and are blocked after publishing critical reports. The Open Net Initiative classifies China's Internet censorship and surveillance as "pervasive." With formal channels of expression severely limited, people take their grievances to the streets. The number of protests and public disturbances has steadily increased and was estimated to stand at 180,000 in 2010. Although protests are common, this figure should be read with caution, because it is very difficult to verify. Furthermore, the overwhelming majority of these protests involve very few people.

Freedom of
expression
2

3 | Rule of Law

The 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, the executive and the judiciary at the central level as well as at the local levels, are responsible to the NPC or local People's Congresses, respectively. Thus, the constitutional framework does not establish a system of separation of powers. Since the CCP is constitutionally defined as the supreme ruler, it commands state institutions, and the NPC and local People's Congresses are subject to CCP directives and control. Hopes from abroad that the NPC or local congresses might play a more independent role have not materialized. Although the rule of law has been enshrined in the constitution, the CCP remains above the law and has been willing to engage in only what is officially referred to as

Separation of
powers
1

“governing the country by law”. This is different from rule by law, because the CCP as an organization trumps the law. Therefore, a system of checks and balances does not exist.

Although the judiciary is institutionally differentiated, there exists a considerable lack of judicial independence. Despite the leadership’s repeated vocal commitment to the rule of law, China’s legal system remains tightly under the control of the CCP and interference with the work of the judiciary still occurs frequently. Particularly within the lower level courts, judges are very susceptible to corruption. The bar lacks independence, as the All-China Lawyers Association is institutionally subordinated to the Ministry of Justice. Particularly in criminal cases and defense of rights cases, lawyers are curtailed when performing their duties, especially in conducting investigations and gathering evidence. In addition, lawyers are often harassed when representing defendants in human rights cases. 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, although it is still considered the highest in the world.

Independent
judiciary
2

Although laws against corruption are in place, they are rarely enforced, except in the form of campaigns. One such campaign took place during the review period. This campaign followed the established practice of corruption being investigated by the Communist Party’s Commission for Discipline and Inspection, which has gained in importance; dozens of high-ranking officials (above the rank of vice-minister) have been targeted, but merely a fraction of cases are submitted to the state judicial organs for prosecution. While it seems that the party leadership is concerned about the spread and levels of corruption and correctly sees this as one of the major stumbling blocks of regime legitimacy and effectiveness, the logic of political survival through distribution of spoils and privileged access to exclusive goods (as in any single-party regime or dictatorship) means that problems of corruption and shortcomings of anti-corruption efforts are systemic.

Prosecution of
office abuse
4

During the review period, office abuse was prosecuted more rigorously than before, but corruption also remained a potential and powerful political tool.

The anti-corruption purge initiated by the Xi Jinping administration targeted officials at all levels and in all sectors of the regime: party, government, representative organs, universities, state-owned enterprises and the military. Anti-corruption laws have become stricter, imposing limits on the gifts officials can receive and the amounts of money they can spend on official banquets. Bo Xilai, the former party secretary of Chongqing, was convicted in a trial that was in large part televised. Foreign media reports, which made their way into China and targeted the huge personal wealth accumulated by the families of leading party cadres (including family members of Xi Jinping), have shattered the stereotype that corruption does not affect the top leadership and is only a local phenomenon. However, anti-corruption campaigns do

not only affect the political realm. During the review period, “petty corruption” in the form of demanding bribes for services has become more difficult. Service providers are monitored with computer programs and even video cameras, and the electronization of financial transactions has imposed additional barriers to corrupt behavior.

The constitution guarantees certain civil rights, such as freedom of speech, of the press, of assembly, of association, of demonstration, of religious belief, of person and so on. Nevertheless, the CCP and state organs frequently interfere with these rights. For example, religious/spiritual groupings, such as underground Protestant churches and Catholic communities allegiant to the pope, are not tolerated by the authorities and activists are frequently persecuted. Maltreatment, physical abuse and torture of prisoners are prevalent. In rural areas, the state is not willing or able to prevent large-scale human rights violations by private actors, resulting in widespread forced labor, abductions and human trafficking. Forced resettlement due to large-scale governmental construction projects or illegal land grabs by local authorities violates people’s property rights. Ethnic minorities are politically and economically discriminated against, as public life is dominated by Han Chinese; minority regions lack significant autonomy rights. Although the Chinese constitution stipulates that both men and women enjoy equal rights and legislation for the protection of women’s rights has been in place since 1996, in practice, women’s rights and opportunities are still severely compromised in many parts of China. While in principle, victims can seek redress for such violations, corruption and the lacking independence of the judiciary hampers the efficacy of these mechanisms.

Civil rights
2

4 | Stability of Democratic Institutions

The formal arrangement of political institutions is characterized by the supremacy of the CCP; thus, the People’s Republic of China (PRC) can be classified as being a one-party authoritarian political system. All leading political actors are recruited from within party ranks. Other political organizations in competition with the CCP are forbidden and suppressed. There are no meaningful general elections through which the people could change the government. The judiciary is not independent; especially in “sensitive” cases involving public disturbances, state secrets or product safety, political involvement in the judicial process and in decision-making is frequent.

Performance of
democratic
institutions
1

Political leaders have endorsed the direct elections of village and urban residents’ committees and encouraged greater transparency and popular participation in local governance. However, these measures are not intended to influence developments at the central level, but aim instead at improving good governance and strengthening party supervision. In addition, these elected bodies are not part of the government’s formal administrative system. Experiments with democratic selection procedures, such as primary elections, have been introduced at the township level, but are slow

Commitment to
democratic
institutions
1

to progress. Even though intellectuals affiliated with government think-tanks and some high-ranking CCP cadres have talked about the virtues of democracy for China (and have come up with labels such as “incremental” or “orderly” democracy), these should not be mistaken as a future commitment to political reform toward a multiparty liberal democracy. Quite to the contrary, on many occasions, the upholding of one-party rule and the socialist system is highlighted while “Western-style democracy” is repudiated.

5 | Political and Social Integration

The party system is dominated by the CCP; even though 8 so-called democratic parties are officially recognized, they are subordinated to the CCP. CCP membership has grown to almost 87 million (by the end of 2014), the proportion of private entrepreneurs, self-employed and college graduates being disproportionately high among new members. This means that the new urban middle-class, as the “winner” amid China’s many economic reforms, now constitutes the country’s most important social base and the backbone of the CCP. Peasants and urban industrial workers in turn have become marginalized.

Party system

1

In China, the system of cooperative associations is very heterogeneous and characterized by differences in the relationship to the state. Mass-organizations such as the All China Federation of Trade Unions, the All China Women’s Federation, or the China Youth League are funded, controlled and supervised by the state and mainly operate as purveyors of CCP policies to respective membership groups. Several interest groups have been established on the initiative of the state and count as “Gongos,” that is, government-organized non-governmental organizations. There also exist NGOs which concentrate mainly on social issues, such as environmental protection, animal welfare, representation of the interests of marginalized groups (women, the disabled, ethnic minorities, children), and provide services, such as legal aid and consumer protection. Homeowner’s associations and business associations, which represent the interests of the well-off strata in Chinese society, often have an impact on local politics. China has a thriving state-approved non-profit sector, in which informal, non-registered associations (an estimated 2 million) are active in areas such as environmental protection, alumni activities or self-help. However, NGOs are poorly connected, lack organizational capacity and funding. As the state tightly controls the working of social associations and rigorously bans politically undesirable NGO activities, large segments of interests remain underrepresented. Some NGOs are supported by foreign donors, with the considerable danger that their agendas are shaped by the donors’ interest.

Interest groups

2

Many Chinese have only vague ideas about democracy and often reveal a conflicted understanding about what the concept means. According to the World Values Survey, Chinese generally think positively about democracy; almost 90% consider having a democratic government a good thing. This attitude partly stems from the fact that the Chinese government calls itself democratic. However, the broad interest in a responsible, incorrupt and predictable form of government has not yet led to demands for political participation. Even if many Chinese today are ready to strongly criticize governmental arbitrariness and officials' chicanery, the overwhelming power of the state frightens off any demands for democratic participatory rights or attempts to become personally engaged in politics.

Approval of
democracy
n/a

While some surveys indicate extremely high levels of interpersonal trust in China (comparable even to Scandinavian countries), there seems to be more bounding than bridging of social capital, rendering the formation of cross-cleavage, intergroup trust more difficult. Parochial trust, i.e. 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 or violations of basic human rights associate for purposes of self-help. These associations are occasionally supported by activist lawyers. These groups are closely watched; since they often aggressively bring social ills and wrongs to the fore, local governments in particular attempt to silence them by suppressing activists and leaders.

Social capital
5

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

China's GDP has continued to grow, albeit at a slower pace than in the previous years. The structural transformation of the economy – from industry to services and from capital investments to consumption – had a minor effect on China's social development and inequality. According to official statistics, the overall distribution of income, measured by the Gini coefficient, was 0.474 in 2012, which most likely is a conservative estimate. Wealth distribution is even more unequal: according to a report by Beijing University, 1% of China's households owns 1/3 of China's wealth. Between 1995 and 2012, the Gini coefficient for household wealth increased from 0.45 to 0.73.

Socioeconomic
barriers
5

Given the absence of a unified national poverty line and statistical manipulation in local governments, China's poverty rate is difficult to pinpoint. According to the senior official in charge of poverty alleviation, 82.49 million people, or 6% of the

population, lived in poverty in 2013. This approximates World Bank statistics when 1.25\$ PPP is applied. If the poverty line is set at 2\$ PPP, the poverty rate is over 18%. However, all statistics indicate that poverty is declining.

China's HDI has continued its slow growth trend and reached 0.719 in 2013, placing China in the class of countries with high human development. The per-capita disposable income in urban-rural areas in 2013 totaled CNY 26,955/CNY 8,896 (\$4,338/\$1,431). The urban-rural income gap declined very slowly to 3:1, but this does not take into account informal incomes, the variation of living standards across China and the effect of rapid urbanization.

Traditionally, Chinese women are well-integrated socially and economically. The female-to-male ratio of the HDI is 0.939, and China's 2013 Gender Inequality Index of 0.202 was ranked 37 in 2013. However, there is discrimination in the labor market. The difference in labor force participation was 14.3% in 2012, and the estimated GNI per capita was 1/3 less for women than for men in 2011.

Women's participation in politics remains severely limited. Only 23.4% of representatives to the National People's Congress are women, and their totals are even lower in the upper echelons of power: no woman has ever been on the CCP's Politburo Standing Committee; only two of 25 members of the Politburo and 10 of 205 members of the Central Committee are women. It is extremely rare for a woman to act as a provincial party secretary or governor.

Ethnic minorities are subject to social and economic exclusion and marginalization, with the majority of China's poor living in minority regions. Especially in the Muslim Xinjiang Uyghur Autonomous Region and the Tibet Autonomous Regions, political marginalization, territorial infiltration and cultural insensitivity by Han Chinese, and unequal access to well-paid work often provoke violent resistance and have led to the formation of separatist movements.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	2268594.3	6039658.5	9490602.6	10360105.2
GDP growth	%	11.4	10.6	7.7	7.4
Inflation (CPI)	%	1.8	3.3	2.6	2.0
Unemployment	%	4.1	4.2	4.6	-

Economic indicators		2005	2010	2013	2014
Foreign direct investment	% of GDP	4.9	4.5	3.7	-
Export growth	%	25.1	27.7	8.7	-
Import growth	%	13.4	20.4	10.8	-
Current account balance	\$ M	132378.0	237810.0	182807.0	-
Public debt	% of GDP	34.1	36.0	39.4	41.1
External debt	\$ M	281113.7	559772.1	874463.3	-
Total debt service	\$ M	27404.5	60388.9	38678.2	-
Cash surplus or deficit	% of GDP	-	-	-	-
Tax revenue	% of GDP	8.6	10.3	-	-
Government consumption	% of GDP	14.2	13.0	13.6	-
Public expnd. on education	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	1.8	2.7	3.1	-
R&D expenditure	% of GDP	1.32	1.76	-	-
Military expenditure	% of GDP	2.0	2.0	2.0	2.1

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

7 | Organization of the Market and Competition

Competition in China is market-based, but the playing field is not level. China's private enterprises dominate the economy: in 2013, they generated more than half of China's GDP. However, most private enterprises are very small and find it difficult to obtain access to markets and capital. These conditions are not uniform across China. Where the private sector dominates, for example in the Pearl River Delta, production chains facilitate independence from state actors. Sectors and areas with strong state involvement are often a difficult environment for private firms. Several of the most successful private enterprises, for example in the high-tech and telecommunications sectors, have their origin in government institutions and were founded by former officials or people with good connections to the government. The legal framework for private business continues to be weak, opaque and arbitrarily implemented.

Market-based
competition
6

The anti-crisis stimulus measures of the Chinese government since 2008 have mostly propped up big state-owned enterprises (SOE) to the detriment of private businesses. Since the outbreak of the financial crisis, private enterprises have found it even more difficult to access bank credit, even though there is plenty available cash in the market; loans primarily have flowed from state banks to SOEs.

Foreign business investments remain subject to government restrictions, yet these restrictions are gradually being repealed. In 2014, the NDRC proposed to reduce the number of restricted sectors for foreign investment from 79 to 35, and the number of sectors where they are only allowed a minority share from 44 to 32. Investments in financial companies are to be made easier, while legal affairs consulting will be prohibited. Repatriation of profits is difficult due to foreign exchange controls and extensive approval and implementation procedures. In September 2013, the government established the Shanghai Free-Trade Zone (SFTZ), where commodities can be imported tax-free and foreign investments are permitted in all but 16 sectors. The SFTZ is also seen as a test lab for full yuan convertibility. Capital account settlements have indeed been made easier than in the rest of China, but full convertibility is still limited and tied to several requirements, because the government fears that an uncontrolled outflow of RMB could negatively affect macroeconomic stability. In contrast, Hong Kong residents can exchange an unlimited amount of yuan since November 2014 in an attempt to facilitate trading between stock exchanges in Hong Kong and Shanghai.

Since 1996, the urban informal sector has been growing rapidly. In 2008, it constituted 60% of China's urban economy and was responsible for 28.8% of China's GDP.

In August 2008, a new anti-monopoly law went into force. It prohibits monopoly agreements between competitors, the abuse of dominant market positions and administrative monopolies. It also aims to tear down artificial trade barriers within China to eliminate local protectionism. The Ministry of Commerce (MOFCOM), National Development and Reform Commission (NDRC) and State Administration for Industry and Commerce are responsible for implementing the law. In February 2014, MOFCOM published provisional regulations for simplified merger control that are similar to EU standards before their reform in January 2014. By the third quarter of 2013, 672 mergers had been cleared unconditionally, and only one merger was blocked. By 2014, 33 foreign companies had been investigated by China's antitrust authorities, with tech companies (e.g. Microsoft, Qualcomm) and car manufacturers (e.g. BMW) among the prominent targets. Regulators reject accusations of unfairly targeting foreign enterprises, pointing out that 90% of the 335 companies investigated by the NDRC were Chinese companies. In some strategic sectors (defense, energy production, petroleum, gas, petrochemicals, coal, civil aviation, shipping), the state upholds the existing monopolies of state-owned enterprises, with the partial exception of the Shanghai Free Trade Zone, where limited investments in shipping and transportation are possible.

Anti-monopoly
policy
7

Since the global financial crisis, China has become somewhat less dependent on foreign trade. While in 2006 exports equaled 36% of China's GDP, the respective figure for 2013 was 26%. Similarly, imports declined from 31% to 24%. However, the export of manufactured products, a large number of which are assembled from imported parts, still plays an important role in the Chinese economy, and in 2012 China surpassed the United States as the world's largest trading nation (merchandise trade, excluding services). Since accession to the WTO in 2001, foreign trade has been continually liberalized; direct intervention in trade decreased, import barriers have been reduced and the average most-favored-nation tariff rate was 9.93% in 2013. Many machinery and material inputs required for manufacturing are tariff-exempt, especially for enterprises operating in the 113 "Comprehensive Bonded Zones" (known as "Special Customs Supervision Zones" before 2014). China entered into bilateral free trade agreements with Switzerland, Iceland, the Republic of Korea and Australia in the review period and was in the process of negotiating a Regional Comprehensive Economic Partnership with ASEAN and Japan, Korea, Australia, New Zealand and India. The fifth WTO Trade Policy Review for China, issued in July 2014, mentions that WTO members sought better access to China's domestic market while complaining about the opaque legal environment (there is no compendium of China's trade laws and regulations in a WTO language) as well as the inconsistent implementation of these laws. Complaints about preferential treatment of SOE, the arbitrary use of technical requirements to limit imports, the use of export restraints and taxes, and the protection of trade secrets and intellectual property rights were also voiced.

Liberalization of
foreign trade
8

Important banking sector reforms were announced in the review period, but assessments by domestic and international observers and experts regarding the quality and strength of banking supervision remain mixed and contradictory, in part because of the lack of reliable first-hand information. By 2016, banks will be able to set higher and more market-oriented interest rates on deposits; local governments will be allowed to issue bonds; a deposit guarantee scheme will be introduced; and, in addition to Minsheng Bank, four more domestic privately owned banks will be established. These measures are aimed at mitigating the considerable risks caused by a fast-growing shadow banking system.

Banking system
6

At first glance, China's banking system appears solid. In 2013, 44.9% of China's banking assets were held by five state-owned commercial banks while 12 joint stock commercial banks accounted for another 17.6%. The remaining shares of total assets are held by 144 city commercial banks (9.2%), more than 300 rural commercial banks (4.7%), three policy banks (8.4%), rural credit cooperatives (6%) and other formal financial institutions (7.4%). Over 400 banks are active in China, but account for only 1.8% of all assets. According to a report issued by the Bank for International Settlements in September 2013, China has fully adopted the Basel III risk-based capital standards, and at 0.9%, the ratio of non-performing loans is very low.

Artificially low interest on deposit loans and relatively high interest on bank loans provide these banks with cheap money. At 6.3% in 2012, the capital-to-assets ratio is rather low by international standards, but high compared with China's previous values, which were as low as 4.4% in 2005. The four biggest state-owned commercial banks (SOCB) are listed on stock exchanges and belong to the world's biggest banks with regard to market capitalization. This has brought not only fresh capital to the system at large, but also foreign accounting groups now review the banks' financial reports, which has resulted in greater transparency. According to WTO commitments, much of the banking sector has been opened to foreign banks and restrictions on foreign banks' local currency businesses have been lifted, but the market share of foreign banks remains small. 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, this excellent performance can partly be explained by the fact that high-risk lending is occurs outside the formal banking system. Stimulus measures by the Chinese government during the global financial crisis led to a relaxation of the rules on informal lending, and trust companies, small lending companies and informal lenders have captured increasing shares of the financial market. Between 2006 and 2013, off-balance sheet lending has increased from 5.5% to 34.6% of GDP. Commercial banks are connected to the shadow banking system. They short-sell wealth management products to finance the high-risk operations of trust companies and are required to lend money to local government investment vehicles. According to the president of the People's Bank of China, 20% of these vehicles were unprofitable. In addition to issuing bonds, a number of local governments have resorted to tapping the informal financial system to roll over their loans. Land and real estate serve as the main collateral, making China's financial system extremely sensitive to real estate bubbles. The lack of information on the true size of the shadow banking system, its various connections with China's commercial banks and the linkages with citizens' deposits and mortgages makes it difficult to estimate the overall impact of a default of informal loans on China's financial system. As a remedy, the central government has increased rates for interbank lending and announced the reforms described above.

8 | Currency and Price Stability

China's inflation rate remained low and stable during the review period. After fluctuations of the consumer price index between -0.7% (2008-2009) and 5.4% (2010-2011), consumer prices increased 2.7% between 2011 and 2012, 2.6% between 2012 and 2013, and 2.06% between 2013 and 2014. Experts raised concerns about the potential beginning of a deflationary cycle. In 2013, imports rose faster than exports (+10.6% and +8.6% respectively), continuing the previous year's trend of an

Anti-inflation /
forex policy

7

increasing trade surplus (2012: \$230.75 billion; 2013: \$259.25 billion). As exports continued to grow, imports fell due to a slump in domestic demand and the price of imported commodities decreased, 2014 saw another large trade surplus. In 2013, foreign direct investments rose 5.3% over 2012, but increased somewhat slower in 2014 (1.7%). In 2014, China's outbound foreign direct investments surpassed incoming investments for the first time. These parameters caused foreign currency reserves to increase to \$3,840 trillion, or nearly 42% of China's GDP in 2013. In 2014, they briefly surpassed \$4 trillion, but dropped below that line in the third quarter of 2014, which some observers attribute to speculative capital being pulled from China. China has a managed exchange rate. In March 2014, the daily trading band for the Chinese yuan against the dollar was increased from 1% to 2%. The currency continued its appreciation against the dollar in 2013 but depreciated slightly in 2014. With the Chinese yuan rather closely following the appreciating dollar over the review period, Chinese exports lost competitiveness when compared to other East Asian trading nations. The Chinese Central Bank is not independent, but under tight oversight by the central government, which sees the financial system as an important instrument for macroeconomic control.

Macroeconomic stability is of utmost importance to the Chinese government. Thus, it is not surprising that the Chinese government initiated another small stimulus package in the second half of 2014, which saw a GDP growth of only 7.4%, down from 7.7% in 2013 and falling short of the projected growth mark of 7.5%. To stimulate the economy and prevent deflation, it further cut interest rates and the required reserve ratio for commercial banks while implementing stimulus measures such as tax breaks for small businesses, the construction of social housing and railway construction. In the review period, falling property prices and slower domestic demand once more caused a decline in China's GDP growth, leading central authorities to announce that a 7-8% growth rate represented the "new normal." However, the government's pro-growth fiscal and monetary measures only reinforced the structural problems of the economy, which is overly dependent on fixed asset investment (50% of GDP) and real estate investment (accounting alone for about 13% of GDP). The basic challenge for Chinese authorities is still the same: to maintain annual growth at a high enough rate to guarantee an adequate number of jobs while at the same time rebalancing the economy toward a more sustainable consumer-driven development path.

Macrostability

8

9 | Private Property

In October 2007, China's first private property rights law came into force. The law "protects the lawful property of individuals," 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 a weak judiciary and to corruption in administrative agencies. All land ownership still remains with the state; this means there are no secure property rights for peasants. To address the problems of forced resettlement caused by large-scale governmental construction projects and illegal land grabs by local authorities, in early 2013 the Chinese government promised to better protect land use rights and to increase compensation to farmers, allowing them to directly negotiate the sale of rural construction land. This rule also gives farmers the possibility to merge plots and employ modern farming technologies on larger fields, thereby increasing productivity and income. The long-term aim is to encourage urbanization and pool rural land for large-scale farming by agricultural enterprises.

Property rights
6

China's private enterprises dominate the economy; in 2013 they generated more than half of China's GDP. However, most private enterprises are very small and find it difficult to obtain access to markets and capital. These conditions are not uniform across China. Where the private sector dominates, for example in the Pearl River Delta, production chains facilitate independence from state actors. Sectors and areas with strong state involvement are often a difficult environment for private firms. Several of the most successful private enterprises, for example in the high-tech and telecommunications sectors, originate in government institutions and were founded by former officials or those with good connections to the government. The legal framework for private business continues to be weak, opaque and arbitrarily implemented.

Private enterprise
6

However, due to murky ownership structures, hidden subsidies and various statistical indicators, it is nearly impossible to draw an exact line between what is referred to in China as the "public" and "non-public" sectors. In November 2014, there were 15.2 million private enterprises and 49.5 million individually owned businesses, which altogether employed 246 million people. 90% of these companies are in the service sector, 8% in industry, and 2% in agriculture. In the 2012 industrial sector, private enterprises made up 55% of all enterprises with a revenue over 20 million yuan and were responsible for 33% of all profits. In recent years, big private enterprises have dominated online retail in China and have become important players in cross-border acquisitions. Although private enterprises also benefit from the private property rights law, some stumbling blocks remain, such as difficult access to capital, licensing procedures hampered by long delays and a lack of transparency, local government favoritism and pressure to pay illegal fees. After a period of favoring SOE over private enterprises, the government has now promised tax breaks for small enterprises, which are mainly found in the private sector.

10 | Welfare Regime

Basic public social security systems covering pensions, health care, unemployment, accidents and maternal care are in place in China and have been gradually extended from the urban to the rural population while a rapidly increasing number of rural poor can now claim social benefits. However, as family farmers are not considered employed, unemployment insurance still only covers employees of urban enterprises and institutional organizations. Furthermore, entitlements depend to a significant degree on the size of contributions, meaning that those with low incomes receive only very basic and limited services. Another serious problem is social security benefits for migrant workers, as many employers do not pay the necessary premiums, even though the law obliges to do so. In addition, although the Social Insurance Law in effect since 2011 mandates the transferability of earned social insurance benefits, it faces severe challenges in practice. Likewise, the large number of Chinese employed in the informal sector suffers from inadequate coverage for social risks. China's urbanization regulations, which were unveiled in 2013 and 2014, stress that the rights and social integration of migrant workers must be improved. Finally, urban and rural social security systems are to be integrated, with the ultimate aim of abolishing discrimination against those with rural household registrations.

According to official statistics, 837 million people were enrolled in the basic pension system by November 2014 and 152.2 million urban residents were covered by unemployment insurance schemes in 2012. Universal health insurance coverage is targeted for 2020. This aim had largely been met in the review period, but the benefits of basic medical insurance are low. In 2012, still more than one third of all health expenditure was paid "out of pocket" by people who see a doctor, while contributions by the government and "society" are 30% and 35% respectively. In 2012, per-capita health expenditure increased to 2,057 yuan (2011: 1,806 yuan; 2010: 1,490 yuan). Since hospitals and doctors often charge arbitrary fees or insist on bribes for service, there is a high degree of uncertainty as to which costs for health care and other risks might be expected in the future. For example, the system is not designed to treat expensive chronic diseases, and the poor can often not afford to pay the patient's contribution, which excludes them from medical insurance benefits.

Facilities for education, social security and public services are developed in urban coastal regions and are steadily improving in the rest of the country. However, the quality of services individuals receive depends on income. China's male-to-female ratio at birth is 1.18 and mirrors the preference of Chinese parents for their first child to be male. Though forbidden, many parents use prenatal diagnostics to determine the sex of their child, and female fetuses are sometimes aborted.

Owing to historical factors, there remains a 5% gender gap in adult literacy (2010), but literacy rates for those aged 15-24 are virtually identical (99.6% female, 99.7%

Social safety nets
5

Equal opportunity
6

male). In terms of gender (but not wealth), China is one of the most equal countries in Asia in terms of access to education. Female enrollment rates are higher than male enrollment rates in primary, secondary and tertiary education. However, females are disadvantaged both in access to jobs and salaries. In 2012, the difference in labor force participation was 14.3%, and GNI per capita was 1/3 less for women than for men in 2011. This marks an overall worsening of the situation: in 1990, women earned almost 80% of men's salaries.

Migrant workers and their children are still disadvantaged, but the Xi Jinping administration is showing commitment to fully integrate migrants into society. The measures proposed in 2013 and 2014 include integration into social security systems, social integration and access to education. This comes on the heels of the closure of several Beijing schools for migrant children.

Especially among the older generation, and in particular in the rural areas, women are not regarded as equals, but the situation is changing for younger generations. Regarding political participation, women held 23.4% of the National People's Congress seats in 2013, but are all but excluded from any organization with decision-making powers. 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 rather high compared with other major (emerging) countries, but was lower than in the past. Growth rates dropped from 9-12% to 7-8%, which has been announced as "the new normal." GDP grew 7.7% in 2013 and 7.4% in 2014. At 2.7% in 2012 and 2.6% in 2013, inflation was low and nurtured fears of deflation. GNI per capita at market exchange rates was \$6,560 in 2013 (Ranking China 107th out of 213 countries as listed by the World Bank). The official rate for urban unemployment was 4.1% (2013), but observers predict total unemployment to surpass 20%. In 2013, government revenue increased 10% to CNY 12.9 trillion; total government expenditure amounted to CNY 13.9 trillion, an increase of 10.9%; gross government debt officially stood at 22.4% of GDP, but is probably much higher as some loans by local governments and state-owned enterprises count as private debt. According to a report by The Economist, combined public and private debt in China equals more than 250% of GDP. Imports and exports totaled \$4.644 trillion in 2013 and China registered a trade surplus of \$259.2 billion (+12.34%). Realized incoming FDI was \$117.6 billion (+5.25%) while outbound non-financial FDI reached a historic high of \$107.84 billion (+22.68%) in 2013. China is emerging as an important source of outbound FDI, which surpassed incoming FDI for the first time in 2014.

Output strength

9

12 | Sustainability

In 2010 China emitted 8.3 billion tons of carbon dioxide, the highest total worldwide and far surpassing that of the U.S. (5.4 billion tons). On a per-capita basis, however, China's emissions are significantly below those of developed countries in Asia, and 1/3 of those in the U.S. Still, in November 2014, the U.S. and China agreed to cut CO2 emissions. China promised to cap its emissions by 2030, and the U.S. pledged to reduce emissions to a figure 28% below its 2005 levels by 2025.

Of great concern to the Chinese authorities are air and water quality. Since 2008, when PM2.5 levels began being regularly measured, Beijing's air has been "unhealthy" nearly half of the time, "very unhealthy" 15% of the time and "hazardous" nearly 5% of the time. Contrary to popular perceptions, air data released by the U.S. State Department shows that air quality has not worsened during the time of observation, but remained constant. Beijing is no exception – according to a survey of China's Ministry of Environment, 1/3 of all days in 74 observed cities did not meet the national air quality standard. Water pollution is another serious problem. According to a report by Xinhua News Agency, only 3% of urban groundwater is fit for drinking. Overall, nearly 60% of China's groundwater was rated "relatively poor" or "very poor."

As pollution is responsible for some premature deaths, it has become a major public concern and is a bottleneck for China's continued development; environmental protection is high on the CCP's agenda. In 2011, coal power plants supplied 69% of China's energy, and as China's coal is high in sulfur, coal firing greatly contributes to air pollution. By 2017, the contribution of coal power plants to China's energy mix is to drop to 65%, to the benefit of water, wind and nuclear energy. In addition, inefficient power plants are being closed. As a short-term measure, nearly six million cars that do not meet emission standards will be pulled off China's roads by the end of 2015. In 2005, the Chinese authorities announced that energy efficiency would be improved; energy consumption per \$1000 of GDP has decreased significantly from 244.6 kg of oil equivalent in 2005 to 202.1 kg in 2011. Finally, in April 2014, the environmental protection law was amended for the first time in 25 years, removing limits on fines for polluters. The problem, however, is implementation, because the incentives for local governments to allow factories to cut production costs by polluting the environment is high while the risk of detection low. In terms of government promotion, GDP growth and investment appeal are still higher priorities than environmental protection.

Environmental
policy
5

China's research and technology sector is rather advanced and continues to improve: spending on R&D as a percentage of GDP has risen from 0.6% (1995) to 2.04% (2013), overtaking Europe in terms of R&D intensity. R&D is heavily driven by foreign companies' investments, and is dispersed unevenly across the country. In 2013, Chinese patent offices received more applications than were received in any other country. However, against 1.9 million patent applications in China stand 958 "triadic" patents (patents granted in China, Japan and Europe) held by Chinese innovators in 2011. In addition, almost one-third of all successful patent applications in China were filed by foreign actors. Still, the number of domestic invention patent applications has increased five-fold to 535,000 between 2005 and 2012. Since invention patents take up to three years to be granted, a steep increase in granted invention patents by Chinese firms is expected in coming years.

Expenditure on education accounted for 4.0% of GDP in 2012, indicating a rising trend and meeting the target outlined in the "Medium and Long-term National Educational Reform and Development Plan (2010 – 2020)." Since previous funding has been distributed unevenly across regions and institutions, favoring urban and coastal regions as well as tertiary institutions, the government is now focusing on rural areas. Unsurprisingly, given the size and heterogeneity of the country and its various provinces and regions, the quality of the education systems remains somewhat uneven. Highly competitive, world-class institutions exist alongside low-quality segments of the educational system. Overall, however, national and province-level education policies ensure a nationwide system of solid education and training.

Education policy /
R&D
8

Transformation Management

I. Level of Difficulty

China's political leaders face several structural constraints, some natural, others man-made. Droughts, floods and earthquakes occur regularly in China and not only cause thousands of deaths every year, but also impede China from achieving its goal of food autarky. Furthermore, environmental degradation and water scarcity increasingly constrain the country's development. China's size, combined with uneven development and underdeveloped regional markets, pose great challenges to landlocked and mountainous provinces in central and western China. Severe income inequality strains not only social stability, but also domestic consumption, thereby limiting the competition needed for innovation. After profiting from a three decades of "demographic dividends" from a large working-age population, the share of retired persons is increasing. As a result of its one-child policy, in 2012 for the first time China's working age population (between 15 and 59 years old) shrank, albeit it only by 3.45 million out of almost 940 million people. China is the first country where the "demographic window," a beneficial relation between the working- and non-working age populations, will close while the country is still in a developmental stage. The one child policy was further relaxed in the review period, but has thus far failed to trigger higher birth rates. With wages increasing substantially (often up to 40% per year), not least due to mass demonstrations, an increasing number of foreign companies are leaving China to relocate manufacturing centers in "cheaper" countries, such as Indonesia, Vietnam or India. The CCP leadership seeks to address this problem by strengthening domestic consumption and encouraging "indigenous innovation," but major challenges are posed by the facts that most Chinese cannot afford high-quality products, most enterprises have narrow profit margins and do not invest in R&D and property rights protection remains lax.

Structural
constraints

6

China lacks a robust tradition of civil society, not least because Chinese society is group-centered. Nevertheless, the number of officially registered social organizations and NGOs has steadily increased from 153,222 to 499,268 in 2012, employing more than 6 million people. Official registration entails finding a government unit to act as a guarantor and fulfilling a number of other requirements that serve to keep a check on social sector growth. However, the number of small and unregistered organizations is estimated to run into the millions. The government is faced with the

Civil society
traditions

9

quandary of needing social participation to enhance the provision of public service while fearing that these organizations may challenge its power. Hence, registered NGOs and non-registered voluntary organizations are only partially able to provide channels for popular participation or representation of social interests. The government's recent exhortations for philanthropic donations are largely ignored.

While there are no irreconcilable ethnic, social or religious cleavages in China, social unrest is commonplace. However, most demonstrations of dissatisfaction with the government policy are small – comprising only a dozen or so people – but are concerned with existential issues like the demolition of houses and the relocation or expropriation of rural land. Although not as frequent, spontaneous and large-scale demonstrations occur almost annually, often in the form of “not in my backyard” protests aimed at polluting factories and waste plants, as was the case with the large protest in Hangzhou in May 2014. Economic development has proceeded in a highly unequal manner, as indicated by widening wealth gaps and unequal access to health care, secondary and higher education, and contributes to the fragmentation of society into a small, affluent group and a large, economically underprivileged group. According to the Hong Kong-based China Labor Bulletin, there were 1,171 strikes between June 2011 and December 2013. Occasionally, conflicts with the police or other state organs lead to outbursts of mass vandalism. Relations between Han Chinese and Tibetan and Uyghur minorities remain tense; control is maintained through a massive, visible police presence in strategic locations. In October 2013, a car loaded with petrol allegedly driven by members of the Uyghur minority drove into a crowd at Tiananmen Square, killing two bystanders and the three people in the car. In March 2014, 29 people were killed in Kunming when 10 persons, allegedly Uyghurs, attacked people at the train station with machetes and knives.

Conflict intensity
5

II. Management Performance

14 | Steering Capability

The Chinese government pursues social stability and economic development as its two main priorities. In contrast, a transformation towards democracy based on the rule of law is not one of the government's long-term strategic aims. Rather, the government follows a deliberate strategy of counterbalancing the threat of pro-democracy tendencies and challenges to the party's political hegemony.

Policymaking is characterized by long-term perspectives and subject to evidence-based impact assessment and strategic planning. The government uses guidelines to provide a framework for binding and non-binding policy objectives. Five-year plans

Question
Score

Prioritization
5

specify social and economic targets, some of which are quantified and binding while others are non-quantified and highlight results that local governments should try to achieve. Major policy changes – like those involving innovation or education – take longer to achieve, so the timeframe is extended to 10 or even 15 years. At the local level, targets are tackled in incrementally by formulating annual plans. These plans have thus far been consistent; yet, while crises might delay the achievement of targets, no five-year plan has been abandoned. Overall capacity is weakened by both the de-facto hierarchization of departments and implementation gaps between envisioned and actual outcomes. Departments concerned with economic development usually take precedence over those with social or environmental portfolios. Local governments are given several abstract achievement targets, the fulfillment of which often depends on their priorities, capabilities and budgetary means.

The central government can effectively implement political priorities that it considers binding, but the range and extent of its capacity to do so depends on its resolve and on the interests of local governments. Moreover, the government is not intending to implement political reform measures that might initiate a transformation towards democracy based on the rule of law.

Implementation
5

Policy implementation is easiest where interests and priorities converge, economic growth being a prominent example. It is most difficult where the priorities of the central government do not match those of local actors, and where it monitors and sanctions non-compliance weakly or not at all. Implementation of a policy against the will of local governments is possible yet costly, and is usually carried out in the form of campaigns. More important than these issues is the fact that the central government depends on local initiative to govern this continent-sized country with institutions that are highly centralized in form. While compliance is important, and can be ensured, in times of crisis the central authorities depend on local initiative to govern routine affairs and to contextualize development targets. In the review period, the Xi administration's campaign against corruption effectively illustrates this fragile balance. The campaign antagonizes the overwhelming majority of local officials, who have no real power to resist it. However, it stymies local initiative, which is likely to adversely affect local development and may ultimately threaten the economic dynamism of the country as a whole.

The Chinese leadership demonstrates the ability and willingness to learn from past experiences and from new sources of knowledge. This willingness is mainly confined to social and economic policies, but also extends to administrative reforms, which are commonplace at the city and county level. Officials and administrators formulate such reforms by learning from past experience and by studying examples at home and abroad. Most notably, participatory elements are applied in law-making, the preparation of budgets and the monitoring of officials, oftentimes using the Internet. However, while these reforms improve governance, they should not be confused with

Policy learning
5

a process of democratization within the regime. In recent years, the leadership ranks have acknowledged that the past priority on unconfined economic development has brought about social conflict, a highly uneven distribution of wealth, environmental deterioration and an inability for most Chinese enterprises to move up the value chain. Former President Hu Jintao's emphasis on more social equality and justness as well as sustainable development is now part of the party constitution and plays an important role in the 12th Five Year Plan (2011 – 2015). These reforms, however, face strong opposition by special interests groups (big state-owned companies and banks) which benefit from unequal access to resources and influential decision-makers, and hamper the implementation of reform measures. The Chinese leadership is not willing to accept that more pluralism and democratic reforms such as media freedom and public participation are required as a safeguard against this sort of undue influence and corruption. Instead, the present Xi Jinping administration seeks to discipline special interest groups by detecting and punishing deviation through the CCP's disciplinary apparatus.

15 | Resource Efficiency

The quality of the civil service has improved; meritocracy through competitive examinations and task-related performance appraisals has been introduced, and the vast majority of civil servants now hold university degrees. E-government and performance monitoring have been widely introduced in China's bureaucracy, and China ranked 70th in the UN E-Government survey 2014, up from rank 78 in 2012. Its E-Government Development Index value was 0.5450, which puts China in the class of countries with an "upper middle" score. Bureaucratic professionalism and efficiency, however, is still undermined by rampant corruption and the overarching power of the CCP, which, through the nomenclature system, influences personnel appointments to upper levels of government and party bureaucracies, putting party loyalty and support for present leaders before professional competence. One reason for corruption is low salaries. In January 2015, civil servants received the first pay raise in 9 years. Although the salaries of the lowest-ranked civil servants were doubled, their new monthly income of CNY 1,320 (\$212) is still very low considering the high costs of living in many of China's cities. China's budgetary system is highly decentralized, with local governments responsible for more than 85% of total government expenditures. The central government takes in over half of all revenues then shares that revenue with the provinces at its discretion. Given the lack of transparency and accountability, fiscal resources are distributed not according to a common and equally implemented scheme but are influenced by the respective provincial leader's political weight and negotiating skills. The central government seems to profit from this arrangement: with 2.1% of GDP, the overall budgetary deficit in 2013 was low when compared with other countries. On the other hand, local government debt, as reported by official data, was CNY 17.9 trillion (\$2.9 trillion) in

Efficient use of
assets

6

June 2013, nearly half of which came from sources other than bank credits. This brings the overall debt ratio to a value that is higher than official figures (22.4% in 2012). There is a tendency at the local level to invest in showy projects and create industrial overcapacity.

The Chinese government often has difficulty reconciling conflicting policy objectives and interests due to a lack of horizontal and vertical coordination as well as friction between administrations at the national, departmental and regional/local levels. These problems result from differing incentives at the central and the local level, and the different priorities of the various ministries. For example, the central government attempts to prioritize sustainable and equitable growth as well as to curb excessive speculation in real estate, but local governments thwart this policy by fueling excess development in their localities to expand employment opportunities and revenues from which they gain individual political and economic profit. However, priority policies are coordinated in so-called Leading Small Groups, steering bodies that consist of high-level officials from different departments. Two new such bodies to improve coordination have been created under the personal leadership of Xi Jinping: one on national security (“National Security Council”), the other on “Comprehensively Deepening Reform”. Crises are tackled by establishing ad-hoc task forces. Although in routine politics, waste resulting from overlapping areas of responsibility and sloppy implementation are considerable, communication channels between the various administrative levels are superb, although this usually only becomes apparent in crises and emergencies when non-conformity results in harsh punishment.

The Xi Jinping administration has initiated the largest anti-corruption campaign since Reform and Opening began in 1978. Targets are officials in the CCP, the government, the military and state-owned companies. Xi announced that this campaign would focus on high-level officials. Former Politburo Standing Committee member Zhou Yongkang, former vice-chairman of the Military Commission Xu Caihou, head of the Central Committee’s United Front Work Department Ling Jihua and vice chairman of the Chinese People’s Political Consultative Conference Su Rong were investigated for corruption in 2013 and 2014, along with 59 persons with the rank of minister or vice minister, which includes provincial (vice) party secretaries. As corruption in the CCP has been systemic and graft, nepotism, bribery and sale of office widespread, it is unclear how targets are chosen, and whether the campaign represents an attempt to weed out political opponents, improve the foundations of China’s development, or both. Apart from systemic political corruption, “petty” corruption – like mandatory payments for better services – is still widespread in Chinese society. However, this has been made somewhat harder with the open government initiative implemented in 2008, which improves access to government information, allows people to request files and enables the payment automatization for taxes, fines and services. Nonetheless, corruption persists, a result of the lack of

Policy
coordination
6

Anti-corruption
policy
5

competitive political processes, institutional checks and balances, accountability mechanisms, an independent judiciary and a free press.

16 | Consensus-Building

The Chinese government remains strongly committed to preventing the emergence of democratic tendencies; there is consensus among the members of the political leadership and the regime coalition that a transformation towards democracy based on the rule of law must be avoided.

Consensus on goals
7

There is broad consensus among Chinese leaders that the continuation of one-party rule, the improvement of living conditions and the defense of national sovereignty and territorial integrity are the country's top goals. Similarly, there is agreement that these goals should be reached through economic development, international integration and the strengthening of China's military force. The Third Plenum of the CCP's 18th Party Congress confirmed that a market economy remains a strategic and long-term goal, and that the CCP wishes to improve governance yet avoid taking steps towards liberal democracy. One Leading Small Group, headed by CCP General Secretary Xi Jinping, has been created to coordinate reforms in the marketization of government services, the structure of SOE, the fiscal system, rural-urban development, citizen consultation and the judiciary, as well as to emphasize the improvement of environmental protection, anti-corruption, Internet control and state security. Although these reforms will not be met with approval by all political actors, their power to veto them is marginal.

Since the late 1980s, the party leadership has been united in their opposition to China becoming a liberal democracy. CCP General Secretary Xi Jinping has pledged to improve the "rule of law" in China, meaning that CCP and government officials will be required to follow formal rules and will be punished for deviation. At the same time, he stresses that the CCP as an organization will remain above the law. An organized opposition to CCP one-party rule does not exist. Any attempt to question the status quo is met with persecution and long-term imprisonment.

Anti-democratic
actors
1

Cleavages exist mainly along ethnic and social lines. Unconstrained competition in unequal markets has caused income and wealth inequality to rise dramatically since the early 1980s, making China one of the most unequal societies in the world. There are 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 of anger by groups of disadvantaged citizens proliferated dramatically and are now commonplace, and one of the CCP's prominent fears is that it may be swept away by a dissatisfied populace. CCP General Secretary Xi Jinping claims to be following the "mass line," a term often associated with Mao Zedong, which raises expectations among the urban and rural poor and

Cleavage /
conflict
management
5

serves to widen the existing cleavage. However, increased expenditures for healthcare and other social services illustrate that the government is seeking to ameliorate these conditions. Furthermore, the government continues to subsidize provinces in western and central China and co-finances poverty alleviation programs in China's poorest counties. Since 2004, income and expenditure differentials between the provinces have been reduced, both because of catch-up development and the central government's redistribution of revenue. The Gini coefficient of provincial revenues and expenditures decreased from 0.47 and 0.35 in 2004 to 0.28 and 0.21 in 2012. Nevertheless, the fact that income and wealth inequality in the general population have not decreased shows that the richest subset of the population in all provinces profits disproportionately from these developments. This is true also for minority provinces and, along with several other factors, is responsible for China's ethnic cleavages. Budgetary transfer payments to Tibet and Xinjiang are disproportionately large, but it is chiefly the rapidly growing Han Chinese population in these provinces that is profiting from infrastructure investments and new economic opportunities. This fact and the CCP central government's lack of respect for the religion and traditions of these people have been major reasons for the rise of separatist movements.

Political decision-making is dominated by internal debates between the CCP and state organs. In recent years, the party and the government have strengthened the integration of expert advice from think tanks and individual academics in formulating policy, and since 2000, the government has tried to strengthen citizen input in policymaking 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, even the limited chances for participation and discourse are strongly regulated, monitored and controlled by state and party organs. In case that public debate becomes too explicitly critical of political processes or developments, such debates are suppressed and individuals leading these debates face harassment and even prosecution. Central government regulations state that the general public should participate in the performance evaluation of local officials and administrative departments, but this policy is implemented only selectively.

The Chinese government regularly invokes collective memories of past injustices suffered from Western "imperialism" or Japanese "militarism" to incite national unity and to garner support for its political goals of national development and grandeur. The "Chinese Dream" concocted by the Xi Jinping administration is a recent example. Once more, the 19th century Opium War is invoked as the reason why China lost its status as a world power; the Xi administration promises to duly restore this status. The "Chinese Dream" mentality is nationalist in so far as it not only demands a return to "Chinese" values in science, technology and even law, but it also entails the blaming of "Western" powers for trying to intentionally undermine

Civil society
participation
3

Reconciliation
4

China's rise. Concerning its own past, the government strictly prohibits all public discourse on human rights violations and does not acknowledge the responsibility of the CCP regime for past injustices, such as the Great Leap Famine, the Cultural Revolution and the Tiananmen massacre.

17 | International Cooperation

China maintains and expands cooperative ties with multilateral institutions such as the IMF, the World Bank and the Asian Development Bank as well as with foreign governments to obtain support for ongoing economic reforms. In the review period, China has proposed and/or initiated several new mechanisms parallel to existing multilateral bodies, such as a new bank by BRICS member countries ("New Development Bank") and the Asian Infrastructure Investment Bank. These initiatives more or less directly challenge the U.S. global (Bretton Woods institutions) and Japanese (ADB) regional leadership roles in economic governance. Some nations, among them 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, health care, social security and legal reforms. China makes efficient use of this support, particularly in areas where it lags technologically, such as in 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 concerning democratic reforms, adherence to human rights standards and the solution of the Taiwan question.

Effective use of support

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In recent years, China has increased efforts to be considered a reliable member of the international community and a dependable partner in bilateral relations. This has been mostly true for trade and economic concerns, but also in part for security cooperation. The country's demand for commodities, capital and consumer goods as well as its role as the hub of Asian transnational production networks has made China a vital trading partner for many countries. At the same time, traditional sources of conflict with western countries have persisted, and in some cases even intensified. Both the United States and the European Union still complain about trade deficits, market access restrictions, forced transfers of know-how and rampant violations of intellectual property rights, as well as the country's hunger for resources, export restrictions or cyber attacks on government networks and private corporations. China's double-digit growth rates in defense spending and its more assertive behavior in regional territorial conflicts have raised concerns in the United States and in regional countries as to whether China's self-proclaimed "peaceful development" will persist.

Credibility

6

Although trade and investment relations with its Asian neighbors continue to deepen, China in 2013 and 2014 saw its overall relationship with Japan and with ASEAN countries (in particular Vietnam and the Philippines) deteriorate considerably, primarily over continuing territorial conflicts in the East China Sea (Diaoyudao/Senkaku islands) and the South China Sea (Spratly Islands, Scarborough Shoal). These issues have led to a perception that China is becoming more aggressive and assertive, especially due to an increasing number of incidents involving the Chinese coast guard or air force entering the disputed territories. As a result, the United States has decided to increase its presence as well as its defense cooperation with regional allies, thereby fueling Chinese suspicions of an anti-China containment policy. It was only towards the end of 2014 that the Chinese government scaled back its provocations and returned to a more conciliatory policy. During the review period, the Xi Jinping administration continued its modernization of the Chinese military (especially its naval forces), shifting the military balance in Asia clearly to its favor. The establishment of a National Security Commission, headed by Xi, illustrates that internal and external security issues have taken center stage. With its plan for a “Silk Road Economic Belt” and a “21 Century Maritime Silk Road” China has clearly signaled its intention to use vast infrastructure programs to increase its leverage over neighboring countries.

Regional
cooperation
6

Strategic Outlook

Developments in the review period have illustrated that structural constraints in China's economy and political system pose severe challenges to the country's ongoing development. The Xi Jinping administration is trying to steer China towards economic and geopolitical greatness, but it faces momentous challenges that prove more trying each year.

In addition to severe environmental pollution, heightened social conflicts and stress on its water resources, China faces the problem of an aging population, which raises concerns not only about the sustainability of the country's fragile social security system, but also the composition of its work force. Labor shortages are driving up wages, which is a positive development if the fundamentals are in place to move economic production up the value chain. China's economic planners are struggling to achieve exactly this aim by shifting production from industrial goods to services, from assembly to indigenous high technology products, and from dependence on FDI and exports to domestic consumption. However, the lax enforcement of private property rights, the discrimination of small and medium enterprises in access to bank credits, small profit margins and a domestic market dominated by consumers that cannot afford high quality goods creates a problematic environment for technological innovation. However, innovation in more than just a few privileged networks of firms, which are often dominated by state actors, would be necessary to help China's manufacturers move up the value chain.

Although first cautious steps have been undertaken to manage this transition, it is unclear if significant improvements will materialize. The economic reforms are too cautious and the urbanization plan too grand; China will continue to prioritize capital investments over private consumption, which is exactly what the government promised to move away from. Part of the problem, as often noted, is corruption, which hinders equal access to credits, resources and justice.

It is doubtful, however, that the ongoing anti-corruption campaign will remedy this situation. Corruption is systemic and endemic in China's political system; China would be the first autocracy to reform itself successfully from within. It is more likely that Xi Jinping's anti-corruption strategy will serve to strengthen his position as supreme decision-maker by removing political opponents and striking fear into China's cadre force. There is a significant risk of China becoming a personalized dictatorship. Equally worrisome is Xi's tendency to hone journalists and teachers to his increasingly nationalist "China Dream" mentality by punishing critical voices for being "unpatriotic."

Appealing to populist sentiment by turning against his own party apparatus is a dangerous game. First, and somewhat paradoxically, anti-corruption creates the perception that corruption is worsening, for it allows observers rare insight into the informal side of Chinese politics – China's Transparency International CPI score has dropped despite two years of the anti-corruption campaign. Second, fear stifles the creativity that has enabled local leaders to create policies tailored to help their localities develop, but does not necessarily reduce corruption – people simply find other ways to bribe or embezzle. In the unfortunate event that both disgruntled officials and a disillusioned public turn against Xi Jinping, the political situation in China could become highly volatile.