

## Author's Response: A Bold Prediction

Revolution is a low probability event, says Minxin Pei (裴敏欣) of the Carnegie Endowment for International Peace. Actually, he says it is worse than that: revolution is a series of low probability events occurring at the same time.<sup>1</sup> Maybe revolutions only take place when unlikely events happen in the right sequence. In any event, Pei explains why there are so few instances of radical societal change throughout history.

However, revolutions do occur. If the news is any guide, the pace of revolutionary change around the world is accelerating. But will there be revolution in China? The regime in Beijing has staked its legitimacy on the ability to deliver prosperity. So any economic downturn threatens the stability of the Chinese Communist Party (CCP).

Now, China stands on the edge of economic failure. Premier Zhu Rongji (朱鎔基) believes China's economy was on the verge of "collapse"

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<sup>1</sup>Minxin Pei, "Book Forum: *The Coming Collapse of China*," Cato Institute, Washington, D.C., September 26, 2001.

in the late 1990s,<sup>2</sup> and Chinese economists are not so sure that things have improved since then. Yet foreign experts, such as Nick Lardy, assure us that almost everything is fine in the People's Republic. So who is right?

As an initial matter, China's economy has been decelerating since the middle of the last decade. Lardy likes to remind us how well the private sector is doing, but statistics tell us that the contribution of this sector is not enough to arrest long-term decline: gross domestic product (GDP) increased by 8.0 percent in 2000; last year growth declined to 7.3 percent. This year statistics show that the economy, despite improvement in the last few months, is on track for another uninspiring performance.<sup>3</sup>

Official figures exaggerate China's output. How can the country experience high growth with worsening deflation and massive unemployment? This combination is not possible in the real world. Although reported tax collections have increased, this is not a sign of an improving economy: Beijing has merely regularized the collection of revenue once kept off official books. Moreover, as Finance Minister Xiang Huaicheng (項懷誠) admitted this June, tax collection numbers are also falsified.<sup>4</sup>

The real story, however, is not that statistics are doctored. The real story is the amounts of fiscal stimulus the government uses to keep the economy going. This year's most important economic figure received virtually no attention: fixed asset investment, the result of pump priming,

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<sup>2</sup>Official and foreign sources widely reported Premier Zhu's remarks. See, e.g., "Major Points of Premier Zhu's Press Conference," available at <<http://www.peopledaily.com.cn>>, March 16, 2002; Owen Brown, "Chinese Premier Zhu Defends Deficit Spending, Criticizes U.S.," Dow Jones Newswires, available at <<http://www.wsj.com>>, March 16, 2002; Jasper Becker, "I Averted Disaster, Says Premier," available at <<http://www.scmp.com>>, March 16, 2002.

<sup>3</sup>Analysts, in proclaiming a pickup in China's economy, have failed to notice that GDP growth for the first half of 2002 is lower than that for the corresponding period in 2001 according to official statistics. In the first half of 2002 growth was recorded as 7.8 percent. In 2001 the corresponding figure was 7.9 percent. See "China's Economy Grew 7.8 Percent in First Half Year," available at <<http://www.peopledaily.com.cn>>, July 16, 2002; Peter Wonacott, "Slowdown Cuts Exports—But Consumers Seem Happy," *Asian Wall Street Journal*, July 23, 2001, A4. In 2002 China faces a slowing world environment, which will eventually affect exports and, therefore, GDP growth.

<sup>4</sup>"Finance Minister Criticizes Exaggerated Income Tax Growth," available at <<http://www.chinaonline.com>>, June 24, 2002.

increased in the first half of this year by an astounding 24.4 percent over the same period in 2001.<sup>5</sup>

Beijing is just buying low-quality growth. Today the central government accounts for more than two-thirds of investment in the country, alarming by any standard. Government spending is inefficient: such spending now grows more than three times faster than GDP. And the story gets worse—pump priming is having little effect on igniting consumer demand. Deflation has returned to the Mainland.

The country can ill afford the fiscal stimulus campaign, now in its fifth year. China is running ever-larger budget deficits, just like the record one announced for this year. China's annual deficit this year is zooming past 3 percent of GDP, the internationally-recognized safety limit.<sup>6</sup> There is no end in sight to this zany spendathon. The current pace is unsustainable.

And out of control. The erosion in the central government's finances was evident in the first quarter of this year. Expenditures rose 23.9 percent while tax revenues increased just 3.4 percent from the same quarter last year.<sup>7</sup> No outside commentary is needed: Finance Minister Xiang himself had one word for the central government's recent spending: "reckless."<sup>8</sup> "The fiscal situation is grim," he said. "Revenue is growing too slowly and expenditure is growing too fast. Not enough money is being collected and

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<sup>5</sup>"Fixed Asset Investment Soars in First Six Months," available at <<http://www.peopledaily.com.cn>>, July 19, 2002.

<sup>6</sup>Even official state media admit that China is bumping up against the 3 percent mark: "The ratio between the budget deficit and gross domestic product (GDP) would grow to around three percent from 2.6 percent last year." See "China Begins to Curb Budget Deficit: Economist," available at <<http://www.peopledaily.com.cn>>, August 2, 2002. The projected budget deficit for 2002 is Rmb309.8 billion (US\$37.4 billion) as announced by Finance Minister Xiang Huaicheng in his work report to the National People's Congress in March 2002. The actual deficit, when it is announced in 2003, will undoubtedly exceed 3 percent of GDP if current trends continue, especially if the central government makes good on its spending promises announced recently.

<sup>7</sup>Peter Wonacott, "China's Economy Expands 7.6%, But Concerns Remain," available at <<http://www.wsj.com>>, April 17, 2002.

<sup>8</sup>Ben Pedley, "China Fin Min Seeks to Curb Expansionary Fiscal Policy," Dow Jones News-wires, available at <<http://www.wsj.com>>, April 22, 2002.

too much is being spent."<sup>9</sup> Yet senior leaders continue policies that they know do not work because they cannot afford long-term solutions.

Unless they can patch up the situation, China will become Asia's Argentina.<sup>10</sup> There is "a potential time bomb," writes economic strategist Chi Lo.<sup>11</sup> Like that South American country, the People's Republic can go from boom to bust in just a few short years. Both countries created growth through fiscal means, attracted foreign direct investment, pegged their currencies to America's, and stuffed their banks with their own bonds. Argentina, last decade's model reformer, was hit when there was a fall in the demand for its debt obligations.

Argentina deferred reforms by living on foreign capital, and China is playing this game too. Capital flows to a country are largely dependent on global liquidity. Because China, this decade's darling, now lives on inward flows, "its ability to sustain investor confidence is crucial," says Chi Lo. "As and when the flow of international capital tightens again, China's deteriorating fiscal and debt conditions will come under international scrutiny."<sup>12</sup>

China as the next Argentina? Today that sounds preposterous. Yet it is worth remembering that Argentina did not have to undergo the shock therapy of joining the World Trade Organization (WTO); China is doing so now. The sweeping promises made to get into that group mean that Chinese technocrats no longer have the same power to continually defer solutions to fundamental problems. For example, Beijing has lost control of the timetable to reform its banking system because of China's commitments to open up this sector. The largest state banks are insolvent, and—as a group—are perhaps the weakest in the world. Beijing must rehabilitate

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<sup>9</sup>Mark O'Neill, "Beijing Heavy Spending Alert," available at <<http://www.scmp.com>>, April 17, 2002.

<sup>10</sup>A portion of the text was reprinted, with revisions, from Gordon G. Chang, "Asia's Argentina?" available at <<http://www.wsj.com>>, June 19, 2002. The Asian Wall Street Journal ©2002 Dow Jones & Company, Inc. All rights reserved.

<sup>11</sup>Chi Lo, "Beijing's Budget Time Bomb," available at <<http://www.wsj.com>>, March 12, 2002.

<sup>12</sup>Ibid.

them in the next half decade to the tune of a half trillion U.S. dollars—or face their failure and the collapse of the economy itself.<sup>13</sup> Despite "reforms," the banks are not getting better.

Also on the verge of bankruptcy is the pension and social welfare system, which has enough cash for just half a year or so of operation. Local governments owe perhaps as much as US\$360 billion to employees and others.<sup>14</sup> And governments at all levels do not provide education, health care, or other essential social services to hundreds of millions of Chinese citizens, something that foreign economists ignore when they tell us how well China is doing.

Beijing talks a lot about structural reform but has implemented very little of it these past few years. In this upcoming period of political transition, during which almost all the top posts in the CCP and central government are supposed to change hands, the paralysis will become even more evident.

All of us can see in China evidence of solutions that could work. Whether Beijing is on the right road is not the issue, however. The critical issue is time. Peasants and workers are impatient. They are not about to wait five more decades to see if CCP economics will work. Despite progress, many Chinese today are hungry, angry, and, worst of all, desperate. Beijing's leaders know how to use the coercive power of the state to keep a lid on unrest. Yet force is only a short-term solution. The issue is time—something that China has little of.

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<sup>13</sup>The magnitude of the nonperforming loans of China's four largest state banks is a matter of some debate. The People's Bank of China, the central bank, says that they constitute 25.37 percent of total lending. Dai Xianglong (戴相龍), the head of that bank, has recently admitted that these loans may amount to as much as 30 percent of total lending if international classification standards are applied. Dai's public comments over the years have consistently underestimated the level of nonperforming loans, so his new 30 percent figure must be at the low end of the range. The consensus foreign estimate is 50 percent. See, e.g., "Controls Rein-In Risk Level," available at <<http://www.scmp.com>>, April 6, 2002. A 50 percent ratio would put nonperforming loans above the half trillion dollar level.

<sup>14</sup>There have been recent news stories to the effect that counties in China owe approximately Rmb3 trillion. The central government admits that such obligations exist but maintains that the total amount is not as large as reported. See "Finance Chief Denies US\$362B of Government Debts at County Level," available at <<http://www.chinaonline.com>>, June 5, 2002.

We can see that time is running out when we look at the broad trends in the People's Republic. Mao Zedong's (毛澤東) centrally-directed political system, essentially unchanged by his successors, could survive behind high and strong walls. Yet as China continues to open up, all the forces that apply around the world—political, economic, and social—will begin to apply in the People's Republic as well. Mao's system cannot survive in a more open environment.

The stress will be too great because the country faces too many challenges—a faltering economy, WTO accession, political transition, and weak world business environment—in a short period of time. Any one of these challenges would be difficult for China to take; add them all together, and we can see why the regime will fail. Analysts can dismiss talk of collapse as they downplay one concern or another, yet the point remains that China faces many challenges all at once, not one challenge at a time.

All these trends leave China at the "tipping point," to borrow the phrase popularized by Malcolm Gladwell. Gladwell likens social change to epidemics, which begin with the smallest of events. "Things can happen all at once, and little changes can make a huge difference," he writes.<sup>15</sup> So change does not always occur gradually; sometimes it takes place in one critical moment. China will tip when something, and probably just an inconsequential event, goes wrong.

Of course, many events go wrong each day in the People's Republic. Why have we not yet seen radical social change? Or to put the question another way, what are the underlying conditions that must exist for revolution to occur? According to many observers, there must be discontent among the people, an alternative to the existing regime, and a failure of the old leadership. Do we see these factors in China?

First, is there discontent? Each day there are hundreds of protests in the People's Republic. Do we see, however, discontent that leads to revolution? For all the demonstrations that we witness, there is almost no popular support for revolutionary change. Anger is often directed

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<sup>15</sup>Malcolm Gladwell, "What is the Tipping Point?" available at <<http://www.gladwell.com>>.

against the corrupt and flagrant behavior of local Party cadres—not the rule of the Party itself, which is largely viewed as the organization representing peasants and workers.

Nonetheless, Jiang Zemin (江澤民) wants to change the nature of the Party by formally admitting private entrepreneurs as members. On the day that entrepreneurs become members is the day that the Party is no longer a revolutionary organization. Class struggle, the essence of Marxism, will be out. Modernity will be in.

When peasants and workers find out that private entrepreneurs have hijacked their party, all the unrest in China will become revolutionary unrest. It will no longer be directed at just the lower-level cadres. Reform, Beijing style, is just about to destroy the Communist Party.

The most frightening aspect of demonstrations is not their increasing size or frequency. What is ominous is the desperation of the protestors. Now barehanded peasants and workers battle the security forces of the state even when those forces are armed. Han Dongfang (韓東方), the labor activist exiled from the Mainland, says, "When all hope is gone, that is when you can fight for what you believe without fear."<sup>16</sup> When angry and desperate peasants and workers realize that no one in society represents them, the CCP will face its greatest challenge.

Second, are there alternatives to the regime? The Party has suppressed most dissent and appears to be the only organization around. How can there be change in these circumstances?

Today, many are arrayed against the modern Chinese state, but these groups have yet to link up. Alliances can, however, come together quickly in this day and age of instant communications. Now, China is more connected with telecommunication devices of every sort. Some say that the worker protests of this spring were spread by the Internet to various provinces across the country.<sup>17</sup> It is too early to say that there is a nationwide

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<sup>16</sup>Han Dongfang, "'When You Lose Hope, You Are Not Afraid of Anything'," available at <<http://www.scmp.com>>, February 24, 2001.

<sup>17</sup>See Philip P. Pan, "Oil Protest Shows Spread of Unrest in China," *Washington Post*, April 24, 2002, A21.



movement, but we are beginning to see the first elements of an opposition. In any event, people around the country are beginning to come together.

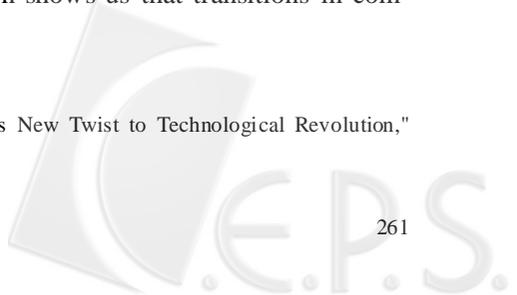
In 1999 China witnessed a bank run propelled by rumors posted on the Internet. Why cannot revolution, another type of event fueled by emotion, be spread electronically? That happened last year when "texting," the sending of text messages by cell phones, brought down Joseph Estrada in the Philippines. Texting permitted ringleaders to organize thousands of protestors with the push of a button.<sup>18</sup> Demonstrations that would never have happened in the past occurred almost spontaneously. When there were too many people in the streets, Estrada had to step aside. The growing connectivity sponsored by the regime in Beijing could, one day, be the CCP's undoing. When protesters become linked together, they can form an opposition. From there, it is just a few short steps to presenting an alternative to the CCP.

Moreover, the nature of societal transformation is itself changing. The role of leaders may be diminishing as spontaneous combustion becomes the model of political change. In China's past, leaders, some of them the most unlikely of individuals, arose from society when opportunity presented itself. They rode change rather than instigating it. The same is true elsewhere: leaders around the world are now swept along, or even created, as people in large numbers gather in the streets. "People Power" is the phrase used in the Philippines, but the concept is the same elsewhere. Change from the bottom is beginning to occur in China too, even though the country is an authoritarian state or perhaps because it is one.

Leaders could emerge from Chinese society again. For example, there are about 65 million members of the CCP. Who among us truly believes that only one of them wants to rule China? When the Party splits over some issue in the future, the leader of the first post-Communist government in China may come from the CCP itself. The current struggle among senior leaders over succession shows us that transitions in com-

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<sup>18</sup>See, e.g., Richard Ehrlich, "Uprising Gives New Twist to Technological Revolution," *Washington Times*, February 2, 2001, A12.



munist countries are inherently destabilizing events. There is no shortage of alternative leaders in China—they are just not visible today.

Third, will China's leaders simply lose the will to govern? Today, those in charge of the country are determined to continue their rule, but, as intransigent as they are, one day they too must pass from the scene. During this upcoming period of political transition anything can happen, such as a split of the Party as mentioned above. The transition will probably take years to complete if history—and the news today—is any guide. So when the challenges to China will be the greatest, the regime will be at its weakest. A weak ruling organization can be swept aside, which almost happened in 1989 even though removal of the CCP was not a goal of the protesters.

Now the Party survives by talking about political reform, but the top leaders defer real change. Yet some day these leaders will have to make good on their vague promises to open up the political system. When they do, Mao's old structure will not survive the popularity contests that democracy will bring. As the regime brings itself into the twenty-first century, China's leaders will soon learn that people want more say in how they are governed. At that time, trapped by their own promises of reform, the leaders will lose their nerve—they will give way.

Finally, increased repression, which clearly demonstrates the CCP's desire to rule, shows that the leaders of the regime feel insecure. Who else is a better judge of the government's own stability? Moreover, the use of force is only a short-term solution because employing violence makes unrest so much harder to control in the future: the coercive power of the state initially subdued the Liaoyang (遼陽市) protests of this spring, but they flared up again because the local authorities tried to suppress the workers too hard.<sup>19</sup> At best, repression only works in the short term as it

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<sup>19</sup>The Liaoyang protest, quelled in March 2002, flared up in May in reaction to the continued detention of labor leaders by authorities. See "Northeast China Workers Resume Protest Amid Threats," available at <<http://www.scmp.com>>, May 9, 2002. In March the protests in that city were prolonged by the harshness of the official response to the initial demonstrations. See, e.g., Michael A. Lev, "Chinese Workers Learn Hard Lesson," *Chicago Tribune*, April 1, 2002, 6.

drives the opposition underground, where resistance can be far more dangerous. Sources say that the banned China Democracy Party (中國民主黨) operates from jail, for instance. The regime still cannot prevent the Falungong from protesting at the time and place of its choosing. Beijing is just playing a losing hand by resorting to coercion.

Regimes are most vulnerable when they try to modernize, and the People's Republic is entering its most dangerous period. We should, therefore, be especially concerned that social order today is crumbling. Experts tell us that the country is stable, but the news from China is anything but reassuring. Beginning last November and continuing into this year, bombings occurred in the People's Republic from one end to another. Then in March we saw the first of the massive worker protests that rocked China.

So the Chinese people tell us that the critical issue for the regime is time. And many of them are desperate. When people are desperate, we can take nothing for granted, not even the accepted truths that tell us when revolutions can occur.

People may say that *The Coming Collapse of China* is bold. Yet the book's prediction is not nearly as startling as the idea that a decrepit and corrupt political organization adhering to a failed nineteenth century ideology can rule an unstable China for all time. If any statement is bold, that is it.

**GORDON G. CHANG**

