



CARNEGIE ENDOWMENT
for International Peace

21

November 2002

Policy Brief

S U M M A R Y

China's leadership transition occurs at a critical juncture. Beijing's new leaders face an emerging governance crisis that consists of a decaying ruling party, deteriorating state capacity, and brewing regime–society tensions.

This crisis originates in the fundamental incompatibility between the Chinese Communist Party's goal of perpetuating one-party rule and the market-oriented reforms it has pursued to achieve this goal. If left unresolved, China's governance crisis could lead to long-term stagnation and social instability. Beijing's new leaders must confront this crisis with long-delayed political reforms. Moreover, China's internal weakness poses a difficult challenge to the Bush administration and calls for a rethinking of the assumptions underlying Washington's China policy. ■

Beijing Drama: China's Governance Crisis and Bush's New Challenge

Minxin Pei

Senior Associate, Carnegie Endowment for International Peace

The Sixteenth Congress of the Chinese Communist Party (CCP) in November 2002 marks the beginning of an uncertain process of leadership transition. Much more than usual is at stake in this transfer of power from an older generation of leaders to a younger one. The new generation must build its own legitimacy while facing an emerging crisis of governance that, if not soon resolved with political reform, could lead to long-term economic and social stagnation and increased political instability in the world's largest country. Meanwhile, on the other side of the Pacific, the United States—long preoccupied with a rising China that could become a “peer competitor”—has paid scant attention to the prospect that China's weakness, rather than its feared strength, poses the graver and more difficult challenge to American national interests.

Irreconcilable Differences

China's crisis of governance stems from the fundamental incompatibility between the CCP's goal of perpetuating its political monopoly and its means of doing so through

market-oriented economic reform. The contradiction inherent in this strategy, which at first was concealed by gains from reform, has become more visible as the Chinese economy has grown more complex, market friendly, and internationally integrated.

To sustain its economic reform, China needs to establish and enforce laws that would significantly curtail the CCP's power. The preservation of a one-party state and the implementation of the rule of law are fundamentally incompatible. Yet the task of subjecting the CCP to the rule of law is further complicated by the state's extensive control over the economy. This control is the key to the CCP's survival as the ruling party because it allows it to maintain support through a vast patronage system. The loyalty of the most critical interest groups (such as the security apparatus, the bureaucracy, and the military) is secured by access to this system. The CCP would undermine its own political base by tying its hands with the rule of law.

In addition, the growing complexity and global orientation of the Chinese economy make centralized control by a one-



Minxin Pei, senior associate and codirector of the China Program, conducts research in Chinese politics, economic reform, East Asian politics, U.S. relations with East Asian countries, and democratization in developing countries. He has published extensively on these topics, and his books include *From Reform to Revolution: The Demise of Communism in China and the Soviet Union* (Harvard University Press, 1994) and *China's Trapped Transition: The Limits of Developmental Autocracy* (Harvard University Press, forthcoming 2004).

Before joining the Endowment, he was a faculty member of the politics department at Princeton University. His many awards and fellowships include the Olin Faculty Fellowship, the National Fellowship of the Hoover Institution, the Robert S. MacNamara Fellowship of the World Bank, and the LaPorte Preceptorship at Princeton University.

party state increasingly untenable. Such an economy thrives on decentralized decision making and an unfettered flow of information. An autocratic party-state with a penchant for direct control is inherently ill suited to govern this type of economy. Thus, the CCP faces an unpleasant choice: either give up its traditional modes of control and risk losing power, or maintain its hold and stifle economic dynamism.

A social transformation has also accompanied China's economic revolution. Rising economic prosperity and expanding personal freedoms have contributed to the emergence of a citizenry that is more aware of its rights and has greater interests to protect. Yet the CCP's restrictions on the formation of autonomous civic groups and mass political participation prevent ordinary citizens from articulating and protecting their interests through the political process. Because they thus have been deprived of a political voice, broad segments of Chinese society have become alienated from the ruling regime. To regain its lost social support and political legitimacy, the CCP would have to open up the political process and broaden its social base. In effect, this would entail making genuine democratic reforms.

A resolution of these irreconcilable differences has eluded the CCP. It can neither afford to halt economic reform and revert to the methods of its discredited Maoist past nor modify its goal of perpetuating its rule and accept a diminished political role. Since the early 1990s, the Chinese leadership has attempted a third way: accelerate economic reform and integration into the world economy, with accession to the World Trade Organization as the most important step in implementing this strategy. The CCP apparently hopes that the gains from reform will build sufficient societal support to sustain its rule.

On the political front, the regime adjusted tactics without changing strategy. It allowed some tinkering with the closed political system, such as limited reform of legal institutions, experiments with village elec-

tions and, most recently, the admission of private entrepreneurs into the CCP. These steps were designed to shore up the CCP's base and maintain social stability without altering the basic features of the one-party state.

However, such muddling through carries costs. The CCP's resistance to substantial curbs on its power has resulted in a progressive decay of China's key political institutions. As a result, China now faces an emerging crisis of governance.

A Crisis of Governance

China's crisis of governance has three particularly worrisome aspects: the decay of the ruling party, deteriorating state capacity, and rising tensions between the regime and society. If not soon reversed through political reform, these trends will threaten the sustainability of China's economic modernization and even its internal stability.

Party Decay

The central cause of China's governance crisis is the decay of the ruling CCP. Given the symbiotic relationship between a party-state and a state-dominated economy, weakening state control over the economy inevitably corrodes the organizational infrastructure of the ruling party. Since the late 1970s, China's economic reform has progressively undermined the socioeconomic bases of the CCP. Economically, market forces have reduced the state's share of economic output and employment (see table 1).

In the countryside, the decollectivization of agriculture has led to the dismantling of the state's old administrative structure and caused a virtual collapse of the CCP's organizational infrastructure. An internal survey conducted by the CCP in the late 1990s concluded that about half of the party's rural branches were either "paralyzed" or "weak."

As reform spread to urban areas in the 1990s, debt-laden state-owned enterprises were liquidated. Consequently, the CCP's networks attached to these enterprises collapsed. At the same time, China's new private firms and enterprises that are partly or

wholly owned by foreign investors have resisted penetration by the CCP. Nearly 90 percent of China's private firms do not have a single CCP member in them, and only 1 percent are able to set up party branches.

The loss of its ideological appeal has also dealt the CCP another blow. Ironically, the regime's success in delivering economic bene-

The CCP's inability to police itself has contributed to the emergence of a collusive local officialdom that has been well documented in the Chinese media. A not atypical example is the municipal government in Shenyang, capital of Liaoning Province in the Northeast. In the late 1990s, almost all of the city's senior officials were involved in bribe

If not soon reversed through political reform, China's crisis of governance will threaten the sustainability of its economic modernization and even its internal stability.

fits through market reforms and opening to the outside world discredited orthodox communist ideology. Opinion surveys conducted in China in recent years show only a minority of ordinary citizens identifying with the values and goals of communism. Although the decline of communist ideology allowed the leadership to adopt more pragmatic policies, it undermined the party's authority on two levels. For the Chinese people, a ruling party that lacks attractive core values has little capacity to maintain popular loyalty beyond delivering acceptable economic performance. Within the ruling elite, the death of ideology breeds cynicism, opportunism, and corruption.

Over time, organizational atrophy and ideological decline have contributed to the weakening of internal discipline and accountability and resulted in rampant corruption. Recent opinion polls in China indicate that, in urban areas, corruption is viewed as the most important cause for concern, surpassing even unemployment. To date, the CCP's own efforts to fight corruption have proven inadequate. Official data show that only 6 percent of CCP members found to have engaged in corrupt activities were prosecuted by the courts in the late 1990s.

taking and providing protection for organized crime. These are the warning signs that political rot may be spreading beyond control, especially at the lower reaches of the Chinese party-state.

Deteriorating State

In a party-state, the decay of the ruling party directly leads to the deterioration of state capacity. As the party fractures into personal patronages, each pursuing its narrow self-interest, the party-state grows progressively less capable of providing public goods, such as health, education, environmental protection, and crime prevention. The symptoms

TABLE 1

The Chinese state's declining share of the economy (percent)

ECONOMIC MEASURE	1978	1999
Industrial output	77.6	28.5
Nonagricultural employment	60.4	29.6

SOURCE: *China's Statistical Digest 2000*.

Signs of a Failing Chinese State

- **DANGEROUS ROADS:** Road fatalities per 10,000 vehicles rose from 34 in 1985 to 58 in 2000 (higher than in India and Indonesia); traffic accidents claimed 106,367 lives in 2001.
- **LOW SOCIAL INVESTMENT:** Education spending was 2.6 percent of gross domestic product in 1998, below the average of 3.4 percent for low-income countries.
- **CRUMBLING PUBLIC HEALTH INFRASTRUCTURE:** China's health system was ranked 144th by the World Health Organization in 2000, behind India, Indonesia, and Bangladesh. Poor health has become a leading cause of rural poverty. HIV/AIDS is spreading rapidly.
- **ENVIRONMENTAL DEGRADATION:** Serious soil erosion afflicts one-third of the country; 75 percent of China's lakes and half of its rivers have been polluted; direct economic losses from environmental damage amounted to almost 8 percent of gross domestic product in the mid-1990s (as compared with levels of about 2 percent in most industrial countries).
- **DEADLY WORKPLACE:** There were more than 1 million industrial accidents resulting in 130,400 fatalities in 2001, including more than 10,000 deaths in mining accidents.

SOURCES: *Chinese Prosecutors Daily*; *Statistical Yearbook of China*; www.chinanews.com.cn; World Health Organization; *Reports to the Central Party School*; World Bank, *World Development Indicators*.

of such a deteriorating state capacity abound in China (see box above). These trends call for a reassessment of China's past achievements because they suggest that economic growth in China is of low quality, gained at the expense of environmental degradation, rising inequality, and falling social investments. And such low-quality growth is ultimately unsustainable.

The deterioration of state capacity is both fiscal and political. The fiscal weakness of the Chinese state is well known. Official data show that the government's tax revenues have declined by half since the late 1970s, from more than 30 percent of gross domestic product (GDP) in 1978 to 14 percent in 2000. This dramatic fiscal deterioration is often blamed for the government's inability to fund

social services adequately. In fact, the precipitous fall in tax receipts has been accompanied by an explosive rise in nontax receipts. Off-budget revenues were estimated to be between 10 and 15 percent of GDP in the late 1990s.

Thus, aggregate government revenues probably remain, as a share of GDP, the same today as 20 years ago. But a fiscal system with half of its receipts kept off the books is obviously more subject to abuse and corruption because of the lack of transparency and control. Additionally, political incentives are such that provincial and municipal governments with access to such funds spend them on inefficient or showcase projects (such as duplicate manufacturing facilities or real estate developments) that can embellish their short-term record. Investment in social sectors, such as education, health, and the environment, is often sacrificed.

Bad as it is, the country's dysfunctional fiscal system conceals the larger political issue: the state's fragmenting authority and progressive loss of control over local governments. The causes of this erosion are complex. To the extent that economic decentralization enhances local political power, the erosion is perhaps inevitable. Moreover, economic reform requires *administrative* decentralization, another factor in the decline of the central government's authority. This changing balance of power directly affects the state's capacity to provide public goods. Local governments with newly acquired revenues have no incentives to provide such goods because they will be consumed elsewhere (for example, a well-educated, healthy worker may find employment in another jurisdiction).

At the same time, a revenue-starved central government lacks the resources to provide public goods. Most important, China's closed political system shuts ordinary people out of the local political process. These consumers of public goods have no voice in deciding how local revenues ought to be spent. As a result, China's local officialdom, insulated from central oversight from above and public pressure from below, has become unaccount-

able. This political environment encourages local officials to subvert public interests with impunity, eviscerating state capacity.

Simmering Disaffection

Measures of social instability indicate growing disaffection between the regime and society in the 1990s (see table 2). Many factors—such as economic dislocation caused by reform, stagnant income in rural areas, high taxes, and increasing inequality—have contributed to this trend. But social frustrations have deeper political roots in China. Social protest is often driven by public anger against

their interests. The absence of genuine democratic participation (despite experimental village elections) also makes it impossible for ordinary people to redress their grievances effectively and politically.

The Challenge for China's New Leaders

Thus, China's new leaders face a dilemma. The regime needs to open up its political system to help ameliorate rising tensions between it and society—despite the high risks of taking this step in the face of its weak legitimacy and brewing social discontent. Inaction will

Bad as it is, China's dysfunctional fiscal system conceals the larger political issue: the state's fragmenting authority and progressive loss of control over local governments.

political disenfranchisement, government abuse of power, and official corruption.

In the countryside, unrest is fueled by onerous taxes (estimated to be as high as 50 percent of gross agricultural output in the mid-1990s), the brutal enforcement of unpopular family-planning policies, and the petty despotism of local officials. In urban areas, laid-off workers for bankrupt state-owned enterprises do not receive their back pay or pensions, even though the officials of the same enterprises enrich themselves through various shady deals—a situation most view as fundamentally unjust.

Unfortunately, China's political system offers little relief to disadvantaged groups. Workers and peasants are not allowed to form independent organizations to fight for their interests. Although China's legal reform has enabled some individuals to use laws to protect their rights, Chinese courts have not yet become effective institutions on which disenfranchised groups can count to look after

only exacerbate the emerging governance crisis. China could descend into long-term stagnation, with slow economic growth, mounting social ills, and an incapacitated state.

To avert this catastrophe, China's new leaders must start implementing a strategy of gradual political reform without delay. At the moment, the CCP can take advantage of negligible political opposition, popular preference for stability, and stable Chinese

TABLE 2

Incidents of collective protests and riots (of significant size)

YEAR	NUMBER OF INCIDENTS
1993	8,700
1995	11,000
1997	15,000
1999	32,000

SOURCE: Ministry of Public Security.

American relations to pursue this strategy. China's new leaders can base the strategy of gradual reform on the institutional framework that has been built in the past two decades: a strengthened legislative branch, an emerging legal system, and village elections. For a start, Beijing's new leaders might consider four steps:

- **Reforming the legislatures.** At present, the members of China's national and local legislatures are not elected directly or competitively. Introducing direct elections or making existing elections competitive would give legislators more legitimacy, increase their political clout, and enable them to curb the excesses of the bureaucracy and respond more

make village elections truly democratic. More important, they should start expanding elections to the larger jurisdiction, townships. This bold step would help reduce tensions between elected village leaders and unelected township governments. In addition, this electoral expansion would introduce a new mechanism of accountability to improve local governance, with negligible risks for the CCP's hold on national power.

- **Empowering civil society.** Current government restrictions on the formation of nongovernmental organizations remain excessively tight. These restrictions need to be loosened to allow China's emerging civil society a greater role in improving gover-

To avert a long-term catastrophe of slow economic growth, mounting social ills, and an incapacitated state, China's new leaders must start implementing a strategy of gradual political reform without delay.

effectively to the needs of the public. If implemented at the local level (township and county), these changes would mark a critical step toward institutional pluralism.

- **Reforming the legal system.** Beijing can make its fledgling legal system more effective through enhanced judicial independence. The central government, not local governments, should finance court operations. The power to appoint judges must be recentralized to minimize local governments' control over the courts. These two measures pose little risk to the CCP, but they would significantly increase judicial independence.

- **Expanding elections.** China's new leaders should continue to enforce existing laws to

effectively. In particular, China's new leaders should encourage the formation of environmental groups, public health groups, and other similar service-oriented organizations to meet needs that the Chinese state is unable to take care of effectively.

To a ruling party long accustomed to total control, these steps may appear too radical and risky. In fact, these are the *minimal* steps required to arrest the perilous trends of political decay in China. These bottom-up measures are not aimed at overthrowing the CCP regime at the national level; they are designed to enable a newly empowered citizenry to reclaim political power from the collusive local officialdom who are the principal source of China's governance crisis. In

exchange for giving up some local control, the CCP can gain more legitimacy and improve its long-term prospects.

Implications for the United States

A China mired in stagnation and poor governance poses a very different challenge for the United States from that on which present U.S. policy is predicated. At present, Washington views the challenge posed by Beijing largely through the prism of geopolitics and national security. This perspective has produced a policy focused on military deterrence against a potential “peer competitor.” Little consideration has been given to the threats that could emerge from a China failing in its historic transition to economic and political modernity.

If U.S. president George W. Bush is determined to pursue the goals of peaceful competition and constructive cooperation with China, his administration needs to shift its focus and develop a policy that seeks, as its primary objective, to promote Chinese good governance and political openness. This does not mean abandoning the components of the current policy that hedge against a China that could challenge vital U.S. interests. Instead, the shift requires a reprioritization of goals. Three measures merit serious consideration:

■ **Presidential commitment.** President Bush should place such issues as good governance, the rule of law, and political openness on the agenda for a top-level dialogue with China’s new leadership. He should signal to the new leaders that substantial improvement in United States–China relations will be unlikely if China fails to take genuine steps in this direction.

■ **Deepening political engagement.** The U.S. administration should reenergize existing programs aimed at promoting good governance, the rule of law, and democratic change in China. President Bush should offer to extend the United States–China presidential initiative on the rule of law that was reached by presidents Jiang Zemin and Bill Clinton in

1997. Congress should increase its funding for programs supporting legal reform, human rights, and democracy in China; the current level of funding, \$10 million (less than a penny per Chinese citizen), is woefully inadequate. Congress, as well as U.S. state and local legislatures, also should reach out to China’s emerging national and local legislative bodies through exchange programs.

■ **New cooperative initiatives.** The U.S. administration should consider new bilateral initiatives to address new challenges, such as China’s AIDS crisis, environmental decay, and massive capital flight (estimated at \$20–30 billion a year). In particular, the United States should seek to reach a bilateral agreement with China on combating money laundering. In recent years, corrupt Chinese government officials have moved large sums of money into the United States (and Canada). The means of such transfer are often illegal or shady. The United States and China do not have an arrangement to seize and recover such stolen assets. It is in the U.S. interest to assist China in blocking the flow of dirty money into the U.S. financial system.

The vision of a constructive and cooperative U.S. relationship with China is unlikely to materialize if China is hobbled by internal woes and weak political leadership. The modest initiatives suggested here constitute a first step toward addressing the threat inherent in China’s deepening crisis of governance. Although they may not yield immediate results, they are the right policy prescriptions for China and for advancing long-term American interests and values. ■

The Carnegie Endowment normally does not take institutional positions on public policy issues; the views presented here do not necessarily reflect the views of the Endowment, its officers, staff, or trustees.

© 2002 Carnegie Endowment for International Peace



CARNEGIE ENDOWMENT
for International Peace

www.ceip.org

**Visit the new Carnegie
Endowment web site:
“A must for the web surfer
interested in global affairs.”**

—Dow Jones Business Directory

The Carnegie Endowment for International Peace is a private, non-profit organization dedicated to advancing cooperation between nations and promoting active international engagement by the United States. Founded in 1910, its work is nonpartisan and dedicated to achieving practical results. Its research is primarily grouped in three areas: the Global Policy Program, the China Program, and the Russian and Eurasian Program.

Related Resources

from Carnegie Endowment

Visit www.ceip.org/pubs for these and other publications

CHINA'S GOVERNANCE CRISIS, Minxin Pei. *Foreign Affairs*, September/October 2002.

REBALANCING U.S.–CHINA RELATIONS, Minxin Pei and Michael Swaine. Carnegie Policy Brief no. 13, February 2002.

FUTURE SHOCK: THE WTO AND POLITICAL CHANGE IN CHINA, Minxin Pei. Carnegie Policy Brief no. 3, February 2001.

WILL CHINA BECOME ANOTHER INDONESIA? Minxin Pei. *Foreign Policy*, Fall 1999.

CARNEGIE ENDOWMENT
for International Peace
1779 Massachusetts Avenue, NW
Washington, DC 20036



www.ceip.org