Bruce J. Dickson

Updating the China Model

China's development model is undergoing dramatic change. No longer relying solely on cheap labor to manufacture exports, the Chinese Communist Party (CCP) is updating its approach in three distinct but interrelated ways. First, it is actively trying to create "national champions" so that Chinese brands—not just Chinese goods—can compete in the global market. Second, it is moving away from its reliance on low-wage, low-skilled labor and encouraging the growth of a middle class and increased domestic consumption to spur economic growth. Third, long accustomed to investing vast amounts of capital on infrastructure projects, it is now devoting more resources toward other types of public goods in order to improve the quality of local governance. Each of these endeavors presents major challenges as well as opportunities for China, its neighbors, and other countries, including the United States. Collectively, they represent a significant updating of the now familiar China model based on export-led growth and a strong state.

These changes are happening for a mix of reasons. From an international perspective, the recent financial crisis revealed China's vulnerability to an economic downturn, which worried the CCP because it relies so much on growth to generate popular support. The global economic slowdown reduced demand for goods produced in China, and because China relies so much on exports for economic growth, the country's rate of growth slowed (although to a still impressive ninth percent in 2009). Many businesses failed, and many workers lost their jobs. Therefore, the financial crisis gave support to those within China who

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favored a more balanced economic development strategy, one less dependent on the international economy and less focused on growth at all costs.

From a domestic perspective, the CCP is starting to cope with the unintended consequences of rapid growth. Its policies produced growing prosperity in the aggregate, but in the process also created growing gaps between rich and poor, the loss of welfare benefits—especially medical insurance and pensions—for large numbers of urban workers, and frequent complaints about a secretive and unresponsive policymaking process. Each of these problems has been the basis for popular protests in recent years. Because political stability is seen as a prerequisite not only for continued economic growth but also for regime continuity, the CCP is motivated to preempt some of the demands that could lead to protest.

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Above all, updating the China model reflects the priorities of the current leadership. Since 2002, the CCP has pursued more populist and less liberal policies. It has given more support to state-owned enterprises relative to the private sector. Under the leadership of President Hu Jintao and Prime Minister Wen Jiabao, the party has balanced the singular focus on growth that characterized the Jiang Zemin era (1989–2002) with a concern for more equitable living standards. While it has been less tolerant of dissent and calls for democracy, it has also implemented grassroots reforms to encourage more consultation between state and society. The official rhetoric has not always matched reality, but the change in priorities has been unmistakable.[1]

Although these changes are in part interrelated, they are best viewed individually because they have different motivations, policies, and implications. Each of these trends is new, and too recent to suggest a definitive verdict. But they have major ramifications for China's political and economic development as well as its relations with the international community. Just as China is updating its development model, we may have to update our assumptions about China's future trajectory as well. Successfully updating the China model would create a new scenario for China's future: the prospect of a modern, evolving, but still non-democratic power. This is a worrisome scenario for those who fear China's rise; for those who look at China's domestic affairs, a stable regime committed to governing better and enjoying a significant degree of popular support is a more appealing scenario than the more common predictions of collapse, stagnation, or muddling through.[2]

The Drive for National Champions

The "China model" is a broad and ill-defined concept. In fact, many in China deny there is a model at all, other than pragmatic adaptations to changing conditions. China's leaders have repeatedly claimed they do not have a blueprint for economic reform, but are simply "crossing the river by feeling for stones."[3] However, this is slightly disingenuous. The twin policies of reform and opening—that is, liberalization of the domestic economy and increased integration with the global economy—have guided China's phenomenal growth of the past 30 years.[4] At a minimum, the China model refers to liberalizing the economy, introducing markets to replace the Soviet-style central planning system, importing foreign capital and technology, and relying heavily on exports. In addition, the China model includes an authoritarian regime to guide economic development, limit access to the policymaking process, and prevent the formation of interest groups, such as labor unions, which would distract from the priority on economic growth.[5]

As China began to reform its economy and welcome foreign trade and investment, foreign companies raced to gain access to more than one billion new customers. Although the hope of foreign companies investing and doing business in China is to gain greater access to the domestic Chinese market, the Chinese government has discouraged domestic consumption (to encourage a high rate of savings, which could then be reinvested into industry and infrastructure), limited the ability of foreign companies to enter China's markets, and encouraged export-oriented industries. In the United States, nearly everyone has goods made in China, but few Americans have goods sold under a Chinese label. Instead, electronic goods made in China are sold by Apple and Dell, textiles are sold by Nike and Dockers, and toys are sold by Mattel and Fisher-Price. In short, China has an export strategy without identifiable Chinese brands.

There are a few exceptions, but even these reinforce the general point. Lenovo sells personal computers under its own name, but it has a small share of the U.S. computer market. More importantly, it entered the U.S. market by buying IBM's hardware operations, not by its own innovation. After the IBM purchase in 2005, its share of the U.S. market shrank: from seven percent in 2006 to just four percent in 2009, and it dropped out of the top five sellers in the United States.[6] Similarly, Haier is a supplier of mini-fridges popular on U.S. college campuses, but lags far behind more well-known brands of other types of home appliances in the United States. Both Lenovo and Haier are major suppliers in the Chinese domestic market, but have had much less success expanding abroad.

As a result, most of the profits from the sale of Chinese exports go to the foreign companies who control the brands. China's leaders are trying to change this dynamic for three reasons: prestige, profits, and to upgrade their economic model. They would, first, like to gain the prestige of having goods that are not only made in China but also sold under Chinese brand names. They also want to capture a larger share of the profits from exported goods. The Chinese companies who manufacture or assemble the goods work under very small profit margins. The growing tensions on trade and currency issues are, frankly, out of proportion with the relatively low profits Chinese companies currently earn. A substantial portion of China's trade surplus with the United States is attributable to goods imported by U.S. companies and sold under U.S. labels. In one well-known example, each iPod imported from China adds about $150 to the U.S. trade deficit with China, but only a few dollars go to the Chinese firms that assemble them.[7] The perception is that China has stolen U.S. manufacturing jobs; the reality is that U.S. companies have decided to outsource these jobs in order to keep their costs down and their profits up. Nevertheless, creating national champions would allow Chinese companies to retain a larger proportion of the profits from their exports. Finally, China's leaders would like to move away from the low-wage, low-skill sectors, and become competitive in industries higher up the value chain, a key step in economic development.[8]

The effort to create national champions is concentrated on state-owned enterprises.

One way they are updating their development model is by attempting to create national champions—firms that will be able to establish brand recognition in foreign markets. They have long been enamored of the Korean model with its *chaebol*—large, integrated conglomerates with close personal, financial, and commercial ties to the government. Companies such as Samsung, Hyundai, and LG are well-known brand names with prominent shares in foreign automobile, electronics, and shipbuilding markets. The Korean model first gained popularity during the 1990s, when the Chinese economy began its rapid and steady growth, but lost favor after the 1997 Asian financial crisis. Now, it is once again in vogue.

The effort to create national champions is concentrated on state-owned enterprises (SOEs). During the recent international financial crisis, China implemented a two-year, $586 billion stimulus package, of which the lion's share went to SOEs. Massive lending to those enterprises continued even after the stimulus package formally ended.[9] The Chinese government has always given preferential treatment to SOEs relative to private firms: for example, bank loans are given primarily to SOEs, and firms listed on Chinese and international stock exchanges are mostly SOEs. The CCP has long been ambivalent about the expanding private sector.[10] Even though the private sector has expanded rapidly over the past 20 years, it does not enjoy the financial support or legal protection offered to the state sector. This trend was reinforced and even increased with the 2009 stimulus package. Much of it was focused on infrastructure projects (and in fact much of the infrastructure spending had been decided beforehand and repackaged as part of the stimulus), and the main beneficiaries were SOEs in the construction, steel, telecommunication, and other strategic industries. As Chinese exports dropped due to weak demand in the international economy, massive investment in infrastructure projects became the primary engine of economic growth and recovery in China.

At the same time, the Chinese government has also continued to restrict access to the Chinese market by foreign companies. Many businesses, associations, and analysts report that the business climate has become even more challenging in recent years, dashing hopes that China's 2001 entry into the World Trade Organization (WTO) would make it easier to do business there. Since China's economic recovery began in 2009, earlier and stronger than most other countries, companies that cannot expand in the China market stand to lose out.

The main challenge China faces in creating national champions is proving it can innovate on its own. To date, this has rarely been the case. It has gained brand recognition by buying companies, such as Geely's purchase of Volvo, or product lines such as Lenovo's purchase of IBM's hardware business. Even its military buys advanced technology from Russia instead of developing it domestically. Chinese firms have produced innovations in manufacturing processes and been very successful in adapting products and services to the Chinese market, but have not yet achieved product innovations for the global market. Almost 70 percent of China's high-tech exports come from wholly foreign-owned enterprises, not Chinese firms or even joint ventures.[11] China's comparative advantage to date has been cheap labor and simple manufacturing. In order to become national champions, Chinese firms will have to be innovative in a way they have not yet been.

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To get around this lack of innovation, the government has adopted a series of new policies designed to spur "indigenous innovation." It first announced this new initiative in 2006, but it did not receive much attention until 2009. The Chinese government is providing financial incentives to encourage Chinese firms to research and develop new high-tech products, and has an ambitious program to lure Chinese scientists and engineers working abroad back to China. At the same time, it announced new regulations requiring foreign companies which seek government procurement contracts to make their technology available for government inspection. Many foreign firms fear it is a bald attempt to force them to share trade secrets, proprietary technology, and intellectual property.

Although many governments require the inspection of goods and technology to certify their safety and reliability, the concern in China's case is that the government would quietly provide the foreign technology to domestic firms, especially SOEs, reducing the competitive edge of foreign firms. Foreign companies have been quite vocal in their resistance to this new regulation, and the Chinese government has backed off from the most controversial aspects of the policy, especially after President Hu's visit to Washington in January 2011, but has not rescinded it altogether.[12] Whether local governments will follow along with the new relaxed rules remains an open question. In China, central policies are not always implemented fully at the local level, frustrating foreign governments and companies who thought they had reached a formal agreement, only to see it unrealized in practice.

A related challenge to creating national champions is enduring suspicion by foreign governments, firms, and consumers about the quality of Chinese-made products. The many recalls of toys and other household items because of lead paint, pet food tainted with melamine (melamine was also added to infant formula sold within China, resulting in the deaths of six infants and kidney damage for 300,000 more), toxic plywood, and similar stories have made many foreign consumers wary of the safety of Chinese imports. Even when a Chinese company has gained a substantial market share by virtue of its products, suspicions remain.

For example, Huawei is one of China's leading technology and communications companies. It quickly gained a large share of the Chinese market, and in recent years also expanded into foreign markets. It is now the leading supplier of technology used in many cell phones and communication equipment. However, its unclear relationship with the Chinese military and government has led some to question whether its technology can be used to obtain privileged information and even state secrets that are then transferred back to China.[13] Republican senators, citing national security concerns, blocked Huawei's bid to supply Sprint Nextel with wireless equipment because Sprint is a major provider of communication technology to the U.S. government. Huawei has also been accused of intellectual property theft; a lawsuit filed by Cisco in 2003 was settled out of court, and a suit by Motorola in 2010 was settled in April 2011.

One area where China has shown its ability to develop new products is in the "green technology" industry. The government has identified this industry as an important new sector, both because it will help alleviate China's voracious demand for energy, along with subsequently large environmental problems, and will give it an edge over other countries that have been slow to move into this area. The government has invested heavily in the research and development of green technology and renewable energy, and is recognized as being well ahead of other countries.[14] China is already the world's largest producer of solar energy panels, and almost all of them are exported. Although the Obama administration has also identified green technology as an important initiative, Washington has not devoted the immense resources to this project that Beijing has.

China's bid to create national champions has important implications for the United States. However, the competing interests among U.S. companies as well as between U.S. government and business complicate concerted action. To date, Washington has been increasing pressure on Beijing to modify its exchange rate, expecting that a stronger yuan would improve the trade balance by making Chinese imports more expensive in the U.S. market and U.S. exports more affordable to Chinese consumers. It has also placed tariffs on Chinese imports that have been dumped on the U.S. market (that is, sold for less than their cost of production, courtesy of government subsidies). These actions have been applauded by companies trying to limit Chinese imports and by labor unions trying to preserve jobs. If China is successful in creating national champions, these groups will be directly and negatively affected because Chinese companies would compete more aggressively and directly in the U.S. market, not just as subcontractors for American brands. The success of national champions could also pose new irritants in U.S.–China trade relations. The United States at the WTO has already disputed China's subsidies of numerous products. State support and sponsorship of national champions would undoubtedly lead to more of these disputes.

On the other hand, many companies engaged in trade with China favor a different approach from currency revaluation pressure. Those that import Chinese goods on behalf of Wal-Mart and other retailers are already seeing their profit margins shrink due to the slight revaluation of the Chinese currency and slight rises in Chinese wages. Some have begun shifting their operations further inland, away from the Chinese coast in order to find cheaper labor, but as a result face higher transportation costs and less experienced workers; others are moving to Vietnam or other Southeast Asian nations.

Conversely, companies trying to export to the Chinese market face a different problem. They have been fighting an ongoing battle against restrictions for years, even decades, and find the current business environment in China to be the worst in recent memory. Firms hoping to do more business in China often prefer a quieter approach than the U.S. government has taken on the exchange rate, trade balance, and alleged Chinese violations of its WTO commitments.

They are less worried about competing against Chinese national champions per se than coping with indigenous innovation policies, and have succeeded in peeling back some of the most worrisome of these restrictive policies. But the environment for foreign business in China remains extremely challenging, exacerbated by the seeming retreat of the CCP's commitment to opening markets and allowing increased competition, and symbolized by the promotion of national champions.

In the long run, China's goal of creating national champions may be just as serious a problem for foreign firms in the Chinese market as for firms trying to limit competition in their own markets, but their preferred remedies may be different. On this as on most issues, U.S. businesses do not speak with one voice. The creation of Chinese national champions would not benefit U.S. business in general, but different businesses would be affected in different ways, and their preferred policy responses by the U.S. government would correspondingly be different.

A Growing Middle Class

The second area in which the CCP is updating the country's development model is related to the first. Just as it hopes to replace the many small and nearly anonymous private firms with national champions, it also is trying to reduce China's reliance on exports by encouraging more domestic consumption, and replacing some of its low-wage, low-skill workforce with higher wages for skilled labor and white collar professionals. In short, China is developing a rapidly growing middle class.

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The desire for more domestic consumption in China is not a direct response to U.S. pressure to adjust its exchange rate, but a recognition among at least some Chinese economists and policymakers that huge trade surpluses are not sustainable, and that the economy needs a better balance between production and consumption. This change would also help alleviate the growing inequality in the country. At the beginning of the reform era more than 30 years ago, China was one of the most egalitarian countries in the world, but that simply meant that most Chinese were equally poor. Since then, inequality has grown markedly: China's Gini coefficient (the standard measure of inequality, where 0 means everyone has exactly the same amount of wealth and 1 means one person has all the wealth) rose from 0.30 in 1982 to 0.47 in 2007, with some estimates now as high as 0.50, which would put China in the company of many

Latin American and African countries.[15] A larger middle class would help to reduce the degree of income inequality. These shifts in orientation are seen by many as the logical next phase of economic development in China.

The current CCP leadership under President Hu and Prime Minister Wen has promoted populist policies to achieve these goals. To improve standards of living, they have provided income subsidies to rural families, lowered some taxes, and entirely eliminated the tax on grain harvests. One consequence of these efforts was that many migrant workers decided to return to their rural homes, creating labor shortages in some key manufacturing and export processing areas, thereby leading to higher wages for the smaller numbers of workers who remained. To achieve more balanced growth, the government directed more investment toward the areas away from the eastern coast, which had experienced explosive growth while the rest of the country lagged behind.

To increase the supply of skilled labor and professionals, it dramatically increased access to higher education, with college enrollments soaring from 5.6 million in 2000 to 22.3 million in 2010.[16] The government has been actively seeking to reverse the brain drain of young talent to foreign countries with promises of high-paying jobs, state-of-the-art research facilities, and generous state subsidies. To free up more money for consumption, it has begun to shore up its national health care insurance system and improve pensions. The rationale here is that if people did not have to save as much for medical emergencies and old age in the future, they would be more willing to spend now. As part of its stimulus spending, the government also launched a large program to subsidize the purchase of consumer durables in the countryside. During the first year of the program, sales of products covered by the program, such as refrigerators, televisions, and washing machines, increased 240 percent.[17] Some of these sales reportedly were to the government, but a large share was to consumers.

These changes were the result of direct government action. It has also taken indirect action to encourage rising wages. During the summer of 2010, the state-run media gave high-profile coverage to labor protests against low wages and poor work conditions. In particular, the media publicized strikes at a Honda plant that shut down for several weeks before a new labor agreement was reached, which included a nearly 25 percent pay raise. It was surely no coincidence that the strikes were at a Japanese factory, not a domestic firm. But the media coverage sent a clear signal that the CCP tacitly favored higher wages for skilled labor. In the weeks and months after these strikes, many local governments raised the official minimum wages in their jurisdictions.[18] Although these standards are often ignored in practice, increases in minimum wages are yet another signal that the state is now less committed to keeping wages low than it had been in the past.

These changes have not gone unchallenged within China. There are a mix of winners and losers in moving from an economy that promotes exports to one that encourages more domestic consumption. In June 2010, China announced it would let its exchange rate fluctuate, but there was little actual movement in the months afterwards. The official explanation was that the government wanted to let the exchange rate rise slowly and gradually to allow Chinese firms to adjust. The more political, but less publicized, explanation was that the powerful and influential interests involved in exporting, including provincial governments and the Ministry of Commerce, were opposed to the policy and lobbied to stop or at least severely slow its implementation.

Even the policy of promoting a more balanced and sustainable pattern of growth has faced opposition. In 2006, Chen Liangyu, the party leader of Shanghai and a Politburo member, was removed from his posts and imprisoned after he opposed Hu and Wen's push for balanced growth, which would come at the expense of the coastal development strategy which benefited cities like Shanghai. His downfall was formally due to allegations of corruption, but his open criticism of Hu's populist approach was the more important cause.

Another key group is also affected by the expansion of the middle class—China's capitalists. Increased wages and worker benefits are squeezing the owners of small and medium enterprises, many of whom are already operating under very narrow profit margins. These private entrepreneurs are also feeling pressure from SOEs, who receive more government support, as previously described. The CCP actively sought the support of private entrepreneurs in the recent past; now, China's private entrepreneurs are worried about their economic futures, which may influence their continued support for the status quo.

A third and quite different challenge to this new trend is the possibility that increased standards of living, spawned in part by higher wages and increased consumer spending, will lead to rising aspirations on the part of Chinese citizens. The key component of modernization theory is that higher levels of education, a more diversified labor force, and increased urbanization produce demands for increased political participation, ultimately leading to democratization. Increased standards of living may increase support for the CCP immediately, but if the success of these policies produces rising aspirations, which in turn create political demands, the ultimate result may be a threat to the regime.[19] For now, the CCP appears confident that it can achieve the short-term benefits while also deferring—or even defeating—any subsequent threat. Its record to date suggests it may not be wrong in drawing that conclusion.

For U.S. observers, it is natural to see an emerging middle class as a positive development. The conventional wisdom views a growing middle class as an indicator of social change leading to democracy. In China, though, all indications are that the middle class is currently generally supportive of the current regime.[20] Many of them are tied to the state in some way, whether by employment or family ties. More importantly, their material interests have benefited from the CCP's policies of reform and opening. They enjoy higher standards of living, are able to buy their own housing, are more able to move from job-to-job and even city-to-city in search of a better life, and face less state interference in their daily lives. With important exceptions, such as the harassment and imprisonment of political activists and the continued enforcement of the one-child policy, most people in China face less overt monitoring and suppression of their daily activities. For similar reasons, the middle class in China is also quite nationalistic, proud of the country's rapid development and emergence as a global power, and resentful of foreign criticism of the government's actions.[21] Those who see the middle class as inherently pro-democracy and critical of the existing non-democratic regime may easily misinterpret the implications of this trend.

Public Goods and Improved Governance

It is often said that China has not undertaken political reforms on the same scale as its economic reforms. This is largely true, but in recent years China has been experimenting with greater transparency in the budgetary process and more consultation in the policy process, such as holding public meetings and soliciting comments via the internet. As a result, the third dimension of updating China's development model concerns improved governance and the provision of public goods.

This area of updating is particularly puzzling. In a democratic regime, politicians are motivated to deliver goods and services to the public at large in order to improve their chances of re-election. But Chinese officials do not need to be popular or responsive to public opinion in order to remain in office. They are not elected or re-elected, but appointed from above. Without the discipline of elections, authoritarian leaders have little incentive to govern better. Rather than implement policies that benefit the public interest, authoritarian leaders typically reward their cronies and key groups (such as the military and security apparatus) to remain in power.[22] And yet, the CCP is trying to improve the quality of governance. The question is why?

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One reason is the CCP's overall goal of maintaining political stability, which it believes to be a precondition for economic development. The CCP is hoping that providing more public goods will enhance its popularity and in return promote order and stability. By all reports, the regime remains remarkably popular despite the often intense criticism of specific problems such as corruption, land grabs, and the social costs of economic reforms like layoffs, the loss of job benefits or pensions, and the growing gap between rich and poor.[23] Improved governance is intended to enhance the regime's popularity and reduce the incidence of popular protests.

A second and related motivation for improved governance is the desire to preempt demands for wider political reforms. The CCP's ultimate goal is to remain in power. It does so by suppressing some real or potential threats, and also by generating popular support through economic development, as noted in the previous section. Now, it is adding other tactics to achieve this goal. It is allowing more consultation in the decisionmaking process, especially in policy areas where the CCP is not itself unified on the correct course or where there is not a clear preference between two competing goals. For example, in recent years it has solicited public comment on proposed reforms concerning major public policy issues. The National People's Congress, China's legislature, received almost 200,000 public comments on its draft labor law over 30 days in 2006. In 2008, the central government posted online the broad goals of reform in the health care system and received almost 30,000 suggestions during a 30-day public comment period. At the local level, governments are also bringing the public into the decisionmaking process. The city of Wenling has pioneered the practice of "democratic consultation" in the budget process, with the public involved in detailed discussions of budget and funding priorities that are then sent to the local legislature for approval.[24]

The recent focus on better governance is in keeping with party traditions of "serving the people," and also fits well with traditional Confucian values.[25] Public opinion surveys have revealed that many Chinese retain the Confucian belief that the state has the obligation and duty to provide for the well-being of the people. This paternalistic notion also influences Chinese assessment of the extent of democracy in China: many define democracy as governing in the interests of the people, not as political rights, civil liberties, and free and fair elections—the liberal definition common in the West.[26] Whether these values motivated Chinese leaders to renew emphasis on governance, or if they simply referred to those values to justify the change in policy, better governance clearly resonates with the Chinese public.

The CCP has long been committed to providing public goods. For much of the reform era, this commitment focused on the kinds of infrastructure projects that spur economic development such as roads, railroads, energy grids, and telecommunications. But now, the CCP is updating the kinds of public goods it is providing to address the consequences of rapid economic development.[27] To address the consequences of SOE reform and privatization, it is slowly rolling out national programs for health care and pensions. These two issues are related to the previous example of updating: if people did not have to save so much of their incomes for medical emergencies and retirement, they would have more money available to buy consumer goods.

To address the tremendous environmental degradation that has been the direct consequence of rapid and unregulated growth, the CCP is trying to find more sustainable energy policies. In 2004, Prime Minister Wen announced plans to develop a "green GDP" index that would take into account the environmental costs of growth. This was quietly dropped because of widespread resistance from local governments, who are evaluated primarily on the basis of annual growth rates (factoring in the environmental costs reduced growth rates to near zero for many cities), and the technical difficulties of devising such an index. But Beijing did not abandon the basic goal of improving the environment. For example, it announced the goal of reducing energy use as a percentage of GDP by 20 percent between 2005 and 2010, with rewards for firms that meet the target, and punishments for those that do not.[28] As noted earlier, China is a global pioneer in the area of green technology. Total energy consumption is still increasing, and in particular the use of coal for generating electricity is on the rise, but the Chinese government is also encouraging more efficient use of energy.

To address the social costs of growth, it is offering new welfare benefits such as higher minimum wages, income subsidies to the poor, and retirement homes for the elderly. These welfare programs are a far cry from the "iron rice bowl" of the past, where workers were guaranteed lifetime jobs and the benefits that came with them, but they represent a new effort to remedy the human costs of the transition to a market economy.

Improving local governance is designed to enhance the regime's popularity, but it is not without risks. For one thing, promoting more consultation without also imposing more accountability may disillusion those who offer their viewpoints, only to have them ignored. Publicizing new channels of participation raises expectations that are rarely met by the CCP. The publicity gives citizens greater understanding of how the system *should* work, but also induces disillusionment when people realize with greater clarity how the system *does* work. Those who become disillusioned with the unresponsive and unaccountable status quo may either revert to passivity or adopt more ambitious claims for political participation.[29] Some local experiments with political reform are the work of incumbent leaders, but may not continue when those leaders are promoted or transferred to other posts.[30] Those who have grown accustomed to participating in the budgetary and policymaking process will understandably resent having that opportunity removed.

An unintended consequence of improved governance may be a stronger civil society. In the areas of the environment and public welfare, groups already have been formed with varying degrees of autonomy from the state. This reflects the paradoxical nature of improving governance in China. On one hand, the CCP recognizes that non-governmental organizations can be useful in providing welfare and other public goods, as well as in obtaining international funding for these pursuits. On the other hand, it fears any group that may have any type of political agenda. These types of ostensibly non-political groups, especially concerning the environment, were a prominent part of the collapse of communism in the Soviet Union as well as Eastern Europe, and the CCP understandably wants to avoid that fate. It therefore carefully monitors these groups, puts limits on their range of activities and sources of funding, and even forces some to disband.

For the same reasons, these groups have drawn the attention of scholars and journalists looking for potential signs of dissent and democratization.[31] In its desire to detect such signs, the CCP also runs the risk of alienating or even eliminating groups that share its stated goal of improving public goods. Moreover, it may also lose foreign funding for important social welfare projects. In spring 2011, the Global Fund to Fight AIDS, Tuberculosis, and Malaria suspended hundreds of millions of dollars in grants for fighting deadly diseases because the Chinese government blocked grassroots organizations from participating in these programs. This is dangerous for victims of these diseases, and also dangerous for China's international reputation.

If the CCP succeeds, it may be able to preempt or postpone more ambitious political reforms.

If the CCP succeeds in improving the quality of its governance and the provision of selected public goods, it may be able to preempt or at least postpone demands for more ambitious political reforms. Of course, there are already voices calling for immediate democratization, but these voices seem to have quite limited public support, much less official approval. Public opinion surveys show that most Chinese believe the current political system is much more democratic today than it was at any time in the past, and are satisfied with the current level of democracy.[32] These findings are disheartening to political activists in China, as well as foreign observers who have been eagerly looking for signs of democratization for more than three decades, but they fit well with the absence of a strong social movement in favor of democratization in China.

Improved governance may also enhance popular support for the status quo, at least in the short run, by showing that the CCP is able to deliver the goods. Just as economic growth is generally believed to be the primary basis for the CCP's legitimacy, better governance is also designed to improve the quality of life for most people. If successful, it may further dampen support for political change. Most key social groups—private entrepreneurs, high-tech specialists, white collar professionals, and so on—have largely benefited from the CCP's reform policies and the economic growth they produced. As a result, these groups tend to accept authoritarianism in China and have little interest in trading the benefits of the status quo for the uncertain advantages of an alternative regime.[33]

But the support of these key groups is by no means guaranteed. In recent years, as the CCP has encouraged increases in living standards through higher wages and increased benefits, private enterprises have been squeezed, and many have failed. Although private entrepreneurs were courted during the 1990s as a key source of support (as symbolized in the "Three Represents," an official slogan that asserts the CCP represents the "advanced productive forces" [a euphemism for private entrepreneurs and other newly emerging urban elites], advanced culture, and the interests of the vast majority of Chinese), their support is shaky today.[34] In order to protect their interests, many businessmen have been sending their savings and even their family members to other countries to guard against their assets being seized by the government and the uncertainty of regime change. This is a worrisome sign for the stability of the regime. In other authoritarian regimes, capitalists were a key source of support; but once capitalists in countries such as Brazil, Mexico, and South Korea lost confidence in the regime's leaders, the regimes tumbled and were replaced by new democratic regimes.[35] The leaders of these regimes learned too late that the support of capitalists was not guaranteed, and they lost power as a result. The CCP has sought and received the support of China's capitalists, but that support may now be wavering.

These recent findings run counter to the conventional wisdom that the main obstacle to political change in China is the CCP's intransigence. The search for signs of democratization is motivated by the assumption that there *should* be support for democracy in China, given the litany of problems we see in the popular media—repression, corruption, pollution, inequality, and so on. The growing numbers of protests are frequently portrayed as the leading edge of an unseen opposition to the regime, perhaps even the beginning of a true civil society.

More often, however, these protests are aimed at making the state govern better, not govern differently. Demands are limited to immediate concerns, not broader demands for systemic change. This may be a strategic choice because protestors know the dire consequences that fall upon those who threaten the CCP, but it nevertheless reflects the limited goals of most protestors and the ability of the CCP to accommodate their demands without sacrificing its hold on power.[36] If the CCP can indeed improve its governance, it will further frustrate political activists in China and disappoint outside observers as well as policymakers who have been hoping, and working, for democracy in China. In the past, the U.S. government assumed there was a tacit harmony of interests between the United States' promotion of democracy and the desires of the Chinese people. In recent years, there has been little evidence to support this assumption.

Conclusion

The three areas identified here where China is updating its development model—branding national champions, growing the middle class, and improving governance and public goods—address some of the most basic goals of China's leaders, and indeed any regime: how they will keep themselves in power, how they will interact with key social groups, and how they will relate with the outside world.

Each of the areas presents great opportunities for China, but also challenges to its success. China has frequently defied predictions about what it was and was not capable of doing, and it would be foolhardy to dismiss the potential success of these changes, or to underestimate their potential impact for foreign competitors. China has not yet shown it can innovate and develop new products to compete in the global economy, but it is now devoting considerable resources to the effort. Moreover, some of its more aggressive efforts at spurring indigenous innovation may drive away foreign companies, if they grow weary of fighting government actions and become less willing to wait patiently for a more hospitable business climate in China. Efforts to promote a middle class society and improve local governance may lead to higher aspirations among Chinese citizens, but the CCP has shown its ability to cope with new societal demands, even if it is often clumsy and occasionally heavy-handed in doing so. In all three areas of change, the trend lines remain uncertain because the tradeoffs are ambiguous.

> If China is successful, it will present new challenges to U.S. market and democracy promotion.

These areas also present challenges to the United States and many other countries. Not all of them are zero-sum struggles, but if China is successful in updating its development model, it will present new challenges to the U.S. goal of promoting markets and democracy, not just in China but around the world as well. A core assumption of U.S. policy toward China has been that economic development and integration with the global economy would not only modernize the country, but also facilitate a democratic transition. The evidence in support of this assumption has to date been meager. If the CCP succeeds in improving living standards and its quality of governance, that will further dampen enthusiasm within China for democratizing reforms, further frustrating those who assume democratization in China is inevitable and even imminent.

More directly, an updated China model may exacerbate national security fears in the United States. Previous efforts of Chinese companies to buy U.S. energy and technology companies (such as Unocal and 3Com) were blocked by the U.S. government. The murky nature of the Chinese government's relationship with SOEs and even supposedly private firms intensifies those fears. As Chinese national champions become more active in the United States, Washington—and even Wall Street—will need to press Beijing for more transparency in the operations of these companies and also monitor their activities here. These diplomatic and national security concerns have been prominent for some time, and will only heighten in years to come.

These three areas will tell us much about the priorities of China's leaders and its future direction.

That is why these three areas of change in China warrant careful attention, particularly as a new generation of leaders takes power in 2012: they will tell us much about the priorities of China's leaders, China's future direction, and what the United States and others will do in response.

Notes

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