

Where China Wants to Go

China is a country whose past weighs heavily on its present and future. It is, in Chinese eyes, a past of glory and also of humiliation, as a great civilization was brought low by those countries that first mastered the Industrial Revolution in the nineteenth and twentieth centuries. As of the mid-1700s China arguably had the world's premier civilization, political system, and economy. By the early decades of the twentieth century, however, it was widely dubbed the sick man of Asia, a country unable to adapt to the modern world, govern itself, or defend its interests.

The very core of the Chinese system—its political hierarchy based on the Confucian system of ethics—had crumbled under the weight of the military and economic capabilities conferred on the West and Japan by virtue of their mastering the technologies of the Industrial Revolution and the scientific and innovative spirit that gave rise to them. The motivating force driving Chinese people of all political persuasions since that low point has been a determination to make China a country of wealth and power, one that could again be regarded as a country of real gravitas.

That same determination drives China's leaders and citizens in 2011 as much as it did a century ago. The difference is that in recent years—after many decades of bitter battles, experimentation, and disappointment—there is a keen feeling throughout the country that at last China has found its way back to security and prominence.

It is a feeling that has stoked very powerful emotions throughout the body politic. It is this feeling that explains why Chinese citizens in public opinion surveys, although repeatedly expressing deep dissatisfaction with the particulars of their own lives, by majorities of 90 percent or more assert that the country is on the right path and that the future will be better than the present. No Chinese leader can go against this sentiment and succeed now or in the foreseeable

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future. The name of the game in Beijing is to keep the momentum going and to find ways to complete China's reemergence as a premier civilization that is both wealthy and strong. It is important, therefore, to look to China's past to understand its core goals for the present and future. Using American or Western assumptions to understand China's aspirations will prove

of very limited utility, as this can obscure the central objectives that are the product the country's bitter historical experience.

Lessons from the Past

An absolutely central problem for China since the mid-nineteenth century has been how to absorb what is necessary from the West while maintaining the essential characteristics that make China unique and put it on a higher plane.¹ Even before the twentieth century began, a basic debate had emerged over the right answer to this central conundrum. The debate had three competing arguments:²

—Argument 1: China is so large that if it can truly unite its people around a core set of beliefs no foreign country, no matter how technologically advanced, can possibly conquer it. The West can defeat China primarily by sowing dissension among China's own people, with some wanting to adopt various parts of Western civilization and products and others wanting to keep the West out. In this view, the West can dictate to China only by making many Chinese want to become Western, and the right approach is, therefore, to unite the people around the fundamentals (Confucianism in the

late 1800s, Mao Zedong's thought by the 1960s and 1970s) that make China unique.

—Argument 2: China must adopt the key things that make the West so strong, while warding off the broader ripple effects in the political system and society that this process may entail. In an iconographic phrase coined in the 1890s, China's strategy should be to "take Chinese learning (about society and governance) for the base and use Western learning (that is, technology) for practical use."³ This is the broad middle ground that has dominated Chinese politics for most of the time since then, but it has repeatedly foundered over the reality that technology affects society in myriad ways, making it nearly impossible to avoid its unintended consequences. That is even more the case in the age of the information revolution.

—Argument 3: Because the key to Western strength is its capacity to innovate, to develop new technology, China must undertake whatever restructuring of its educational system, economy, society, and politics is necessary in order to become a technologically innovative country on a par with the West. The West is too conniving ever to give or sell China the very latest technology, as that would threaten Western superiority. Therefore, those who adopt the middle view are naive and will never lead China to equality with the West. Nothing should be held sacred in the extent of change permissible in order to become technologically as dynamic as the West.

Three strands unite the three arguments above. First, China is profoundly suspicious of Western motives, regardless of what words Westerners use and what commitments they make. There is a deep-seated national belief in China that the West will do whatever is necessary to constrain China's rise and maintain its own superiority. That belief is now especially focused on the United States, given America's preeminent global position and China's recent rapid rise. It produces enduring distrust of American motives and countless conspiracy theories to explain away well-intentioned American actions.

For example, China has long chafed at the sense that Americans regarded the country as a second-class power. Even through the 1990s, the Chinese resented American preaching about human

rights, the need for China to accept global norms (most of which were shaped by American power), and a general sense of American superiority. When Barack Obama became president, he shifted the rhetoric to treat China as a major global player and bring it to the high table on such global issues as restructuring the international financial system, addressing global climate change, and constraining the proliferation of nuclear weapons. The response? Many in China argue that Obama made this shift simply to lure China into making commitments on global issues instead of focusing on its own economic development. This was thus simply the latest American conspiracy to trick the unwary in Beijing into moving onto a course that would slow—and might eventually derail—China’s rise.⁴

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The second strand is a focus on technology as the key to Western strength and to China’s vulnerability. The capacity for technological innovation has been the Holy Grail among Chinese thinkers for the better part of two centuries. How to become an innovative society without having to become a Western society in the process has been perhaps the central problem

of modern China. Those on the very far left (for example, Mao Zedong during the Cultural Revolution of the 1960s and 1970s) and on the very far right (for example, the Boxers of the 1890s) have felt they could solve the problem by cutting China off from the West and purging Western influence. But all such radical efforts have failed disastrously, and this is no longer a viable strand in twenty-first-century China.

The first two strands are fundamental to the third: the need to achieve a position in which the West can no longer tell China what to do and how to do it—or to inflict punishment if China proves resistant to its demands. Even when Western admonitions are recognized as potentially helpful to China, there is a deep-rooted urge to demonstrate that China need not do as the West demands. As Vice Premier Wang Qishan reportedly responded to EU Trade Commissioner Catherine Ashton when she raised concerns about

obstacles to market access in China's automotive sector in a May 2009 meeting, "I know you have complaints, but the charm of the Chinese market is irresistible."⁵ In short, given China's strong performance and the West's deep distress at the height of the global financial crisis, China need not be responsive to Western concerns about how it operates.

This third strand, buttressed by over a century of bitter experiences of foreign conquest and domestic turmoil, has created an extraordinary focus on the need to maintain a powerful state domestically and to protect the country's sovereignty and territorial integrity internationally. National cohesion is prioritized precisely because it has been so hard to achieve and maintain, and the state itself plays a huge role in forging that cohesion and protecting it against foreign and domestic challenges.

The dominant argument, of taking Chinese learning for the base and Western learning for practical use, has been the source of endless argument since its inception. How much Western learning should be permitted? Should Chinese study only Western technologies and products; or should the philosophical systems and rational thought patterns that produced these new technologies also be introduced? How can China highlight advanced Western accomplishments without instilling a sense of futility, a belief that China can never catch up? Where is one to draw the line between Western enough and too Western? How is one to determine what to absorb from the West, when it must be assumed that a key goal of the West is to trick China into beliefs and approaches that will ensure its ongoing inferiority? These questions have been at the core of Chinese politics for well over a century, and disagreements over them have repeatedly thrown the country into turmoil and even civil war.

One must understand this background to appreciate what has been happening in China since 1998—and especially since the onset of the global financial crisis in 2008. During these years China has sustained extremely fast growth and become the second-largest economy in the world.⁶ In the first decade of this period it rebounded from the Asian financial crisis, joined the World Trade Organization, transformed its huge state sector from being a drag

on the national economy to being relatively profitable, vastly accelerated growth of its exports, became the world's second-largest creditor nation, and put its disastrously weak state-owned banks onto basically sound footing.

Since the onset of the global financial crisis China has maintained the fastest rate of growth of any major economy, and it is emerging from the crisis with a lower level of government debt (as a percentage of GDP) than that of the major industrialized countries.⁷ During these same two years Beijing racked up other accomplishments that in its eyes are breathtaking: staging world-class Olympic games in the summer of 2008, coping with widespread ethnic violence in Tibet and Xinjiang, responding effectively to the devastating Wenchuan earthquake in Sichuan province in 2008, getting through a whole series of politically very sensitive anniversaries (including staging an extraordinary military parade display for the sixtieth anniversary of the founding of the People's Republic of China in October) during the course of 2009 without major incident, and holding the World Expo in Shanghai in 2010.

While China compiled this extraordinary record, the West—and especially the United States—stumbled catastrophically. The global financial crisis that began on Wall Street and rippled across the world was based primarily on financial products made in America. The result has left America shaken, poorer, deeply in debt, and uncertain of its future. It has sharply diminished the luster of the American model, punching an enormous hole in the facade of almost unlimited capability that America had long maintained.

The U.S. Treasury Secretary (and former chairman of Goldman Sachs) Hank Paulson had in recent years lectured the Chinese time and again on the importance of their moving toward the type of open, innovative financial system that, he argued, explained so much of American success.⁸ Now that argument, once taken very seriously in Beijing, appeared fraudulent, and China's reluctance to accept it appeared retrospectively a mark of wisdom.

As China looks forward, therefore, it sees itself as having developed crucial momentum toward regaining its historic position of wealth, power, and respect. It has established a decades-long record

of rapid growth, which it has kept on track despite unanticipated problems and major crises. And the West has stumbled badly, tarnishing its luster and diminishing its strength and confidence. The population in China can feel this in its bones, and it is a transition that is constantly nurtured in the Chinese media.

A photo of Robert Zoellick on the cover of a Chinese journal published in spring 2010 captures the Chinese attitude. Zoellick, while a U.S. State Department official, had in 2005 famously called on China to be a “responsible stakeholder” in the global system.⁹ By 2010 Zoellick was the head of the World Bank, a position traditionally filled by the United States. But in this photo Zoellick is bowing slightly, hands clasped, the posture of submission in Chinese etiquette. The cover story is titled, “Power Moves from West to East.”

This is the new narrative, and every Chinese leader as of 2011 must sustain it. Yet they know that the model of economic development they are following—the one that has carried them to the cusp of global power—is inherently flawed. It has not solved the technology problem, and it is based on core assumptions that are increasingly untenable: an abundance of cheap labor, popular tolerance of increasing inequality and corruption, an environmental cushion that permits almost unbridled degradation to grow the GDP, and open export markets.

New Approaches

Pragmatism has been a hallmark of China’s reforms over the past thirty years, as China’s leaders have not flinched from a realistic view of their challenges. They typically experiment with various approaches before deciding on the best ways to address major concerns. And they have created a political system that permits a great deal of flexibility in the implementation of policy decisions across a vast and diverse continent.

As they address the need to change their development model, they are seeking to maintain the key characteristics of their system that they feel are working well and to make the modifications

necessary to carry success into the future. Since nobody knows the future, and since China's scale and complexity are historically unparalleled, there are naturally ongoing debates as to specifics virtually across the board. Those debates are shaped and constrained by the lessons of history noted above. In summary form, the major decisions to date are as follows.

Continuation of authoritarian rule by the Chinese Communist Party provides the only hope of implementing the tough measures necessary to enable the country to continue its rise to global prominence. Party leaders are adopting numerous reforms in terms of recruitment, training, promotion, and internal procedures to improve the quality of the party itself.¹⁰ But one-party rule is so important that virtually any action will be adopted if necessary to preserve this.

More must be done to establish a social safety net. This is intended to chip away at the extraordinarily high household savings rate, which constrains household demand. It should also mitigate the social tensions that produce strikes, riots, and other forms of social disorder. And measures are being taken on wages and other issues to increase household consumption at a faster rate than has been the case in recent decades. The catchphrase for this effort is *creating a harmonious society*.¹¹

The leaders have also concluded that their success in positioning China as the point of final assembly in an integrated East and Southeast Asian manufacturing system—where firms along China's east coast import high-value added parts and components produced elsewhere in Asia, add some value via final assembly and packaging, and then export these products to North America and Europe—has enabled China to grow its economy but is no longer the key to future development. A second aspect of this strategy—inviting foreign firms to invest in manufacturing capacity in China to produce products they have designed abroad and that are intended primarily for export—has put the most energy- and pollution-intensive parts of the value chain in the People's Republic of China. This overall strategy has kept the country at the low end of the international value chain, where it has achieved preeminence in metal

bending but not in the higher value-added R&D, product design and development, sales, service, branding, and finance, which are key to prosperity on a nationwide basis.¹²

China's leaders are therefore now trying to reposition the country economically. The major thrusts of this new approach are as follow:

—Focus on creating the capacity to become a technological leader. Priority measures include expanding and improving university training, attracting back to China key talent that went abroad for study, leveraging technology transfer from foreign firms as a condition for market access, and designing financing mechanisms and regulatory and government procurement standards to build scale for Chinese technologies and to constrain international firms' technological options. This set of initiatives is being pursued on a huge scale, especially since the global economic crisis has significantly enhanced the importance of access to the Chinese market. The catchphrase for this overall effort is *creating a capacity for indigenous innovation*.¹³

—Make China a globally competitive player in green technologies. China's leaders see the country as having suffered grievously for having missed the Industrial Revolution and been a buyer rather than a seller in the information revolution. They see as inevitable a growing price premium on carbon emissions, and they want China to become a leader in the upcoming low carbon revolution. This is producing extraordinary levels of investment of \$440 billion in clean energy projects this decade, plus \$9 billion a month in clean-technology research and development.¹⁴ And all of the indigenous technology program levers are being pulled to maximize technology transfer in this vital area from advanced industrial countries to China. The catchphrase for this effort is *pursuing scientific development*.¹⁵

—Allocate resources to develop the cities of inland provinces and to increase the standard of living in rural areas. Infrastructure investments are increasingly concentrated in inland cities and the transportation arteries that connect them. Very rapid growth is being encouraged in tier 2 and tier 3 cities, to the point where China now has well over 100 cities with a population of more than

a million residents each. And efforts are being made to accelerate development of the service sector, which as a percentage of GDP is the lowest among major economies in the world. The catchphrase for this set of measures is *pursuing balanced development*.¹⁶

This set of measures is, in short, intended to leverage China's economic capabilities to address the critical issues of inequality, pollution, constrained future prospects for export-led growth, and technological lag. Party leaders are prepared to spend enormous sums of money to achieve their objectives and will fully utilize the power of the state to direct resources and to cope with resulting tensions. If China sustains a rate of GDP growth of nearly 10 percent over the coming decade—as it has on average over the past thirty years—it will be because of significant changes in what it has done to date.

Outcomes rarely occur according to plan. China's future will be shaped by the above major initiatives and also, crucially, by the major demand drivers and constraints that are largely beyond the reach of public policy. The following chapter explicates those drivers and constraints to provide texture to the prospects for the country's growth over the coming decade. As with each national goal and program, of course, every driver and constraint offers business opportunities for companies with relevant ambitions and capabilities.