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On the Record: Gunter on China

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With the state visit by China's President Hu Jintao, I am reminded that the more things change in China, the more they stay the same. Two decades of incredible economic growth in the People's Republic has made China the world's second largest economy (adjusting for cost of living) after the United States. But no amount of news print detailing this boom, or photo ops between state leaders, or predictions about when China's economy will surpass that of our own—can change the short and long-term challenges that China's leadership face.

In the short-term, Chinese macroeconomic policy is on a tightrope. Food prices have risen an estimated 10.1 percent this year, which has led to severe hardships among hundreds of millions of low-income Chinese. There have been hundreds of protests – some of them violent. In response, the government is attempting to cool off the economy by increasing bank reserve requirements. But if the economy slows too rapidly, then unemployment—already an estimated 9.6 percent—will worsen.

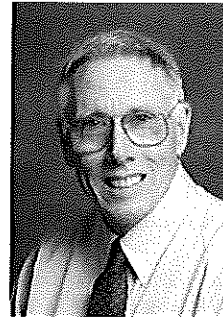
Yet there may be even more pressing matters than rising prices. Put simply, China's burgeoning economy is ever hampered by China's political economy, affecting their demographics, environment, economic institutions, and perhaps even the very legitimacy of their government.

Demographically, the one-child policy has contributed to the average Chinese couple having only 1.54 children. As a result, China's population is not only aging rapidly but also, because of the cultural bias in favor of male children, the male-female gap is increasing. The number of economically most productive persons in China will begin to decrease soon, while the same aged group continues to grow in India. And with males under 65 outnumbering females by an estimated 42 million, Chinese society will have to cope with the instability caused by large numbers of men excluded from forming traditional families.

Environment. Rapid economic growth combined with the inability of the government to enforce existing laws has led to environmental disaster in China. Air quality is very poor and continues to deteriorate due to heavy reliance on coal. Water shortages are combined with multiple cases of drinking water contaminated by untreated waste. The loss of agricultural land from desertification, urbanization, and erosion is accelerating.

Economic Institutions. Although there has been dramatic liberalization of the Chinese economy, the most important economic institutions are still controlled by the government. This is reflected in the very different sources of economic growth in China compared to other large economies. For example, in the United States, 70 percent of GDP is accounted for by private sector consumption with investment, government spending, and net exports accounting for the remainder. In China, these ratios are reversed: consumption is only about a third of the nation's GDP. The economy is still dominated by institutions subject to strong government influence such as the major banks, stock exchanges, and state owned enterprises. In China, regulatory and investment decisions are often made more on the basis of political influence rather than economic rationality. One concern is that "a falling tide reveals the rocks" – that any economic slowdown will reveal massive bad debts in the public banks' portfolios.

Governmental Legitimacy. The legitimacy of the Chinese government is becoming increasingly precarious. Traditionally, legitimacy has depended on three pillars: ideology, nationalism, and prosperity. As belief in communism continues to recede in China, there is search for an alternative ideology. The old men who run China still view democracy, the dominant ideology in the much of the world, as a threat to their power and status. (It is interesting to note that for the first time in modern Chinese history, the government last year celebrated the birth of Confucius. In the short-term, this official approval of


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Confucianism, which encourages respect for authority, may strengthen the Party. But it may also create a long-term risk since Confucianism provides standards against which the people might judge their leaders.)

Especially since Tiananmen Square in 1989, when Liu Xiabo began his march to the 2010 Nobel Peace Prize, economic prosperity has been the most reliable of the pillars of governmental legitimacy in China. There have been dramatic improvements in living standards and these economic improvements have led to substantial support for the Chinese Communist Party even as belief in communism continues to dissipate. However, the lack of a widely accepted ideology means that any extended economic slowdown will shake the perceived legitimacy of the government.

Optimistically, this could lead to a revival of the democracy movement in China that has long been stalled at the village level. However, should the economy stall, it is just as likely that a threatened Party will seek popular support by encouraging nationalism.

Nationalism, of course, may be benign or malign. China possesses incredible literature, natural sights, and history. To the extent that the government can associate itself with these examples of benign nationalism, it is perceived as more legitimate. On the other hand, nations throughout history have manufactured conflicts with other nations in attempts to maintain domestic support for the government. A threatened party may seek popular support by inviting conflicts with its neighbors and, its only peer competitor, the United States. If so, China may be a greater challenge to the world community than the current worldwide recession and the war against terror combined.

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