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China's Coming Era of Slow Growth

William H. Overholt
Harvard Kennedy School

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China's Coming Era of Slow Growth[1]

William H. Overholt

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Summary

The best way to understand China's present and future is that the Chinese reform era emulated the "Little Dragons," South Korea, Taiwan, and (to a lesser degree) Singapore. The little dragons were initially run by ruthless hierarchical politics and highly centralized economic management, guided by Marxist-Leninist ideas. Mobilized by fear of imminent national catastrophe, they focused on economic growth, informed by egalitarian efforts to ensure the broadest social support. They typically experienced a generation of growth at nearly a 10 percent annual rate, then a crisis of success brought on by emerging social complexity, bursting of economic bubbles, exhaustion of the early drivers of growth, and a financial squeeze of the government and government-associated companies. They responded to social complexity by moving to more market-oriented economics and politics, at the cost of the old hierarchical, centralized institutions. The generation of 10 percent growth gave way to a period of 7 percent growth and then declined to a relatively stable 3 percent. Through this process they achieved high incomes, high technology and high domestic stability.

Emulating the little dragons, China has had its generation of 10 percent growth and is now in the era of crisis of success with lower growth. By 2030 or before its potential growth will have declined to around 3 percent. However, instead of accommodating social complexity by moving to more market-dominated economics and politics, China is fighting the complexity revolution. Instead of sacrificing the interests of Party and state-affiliated firms to the pressures of a more complex society, China is prioritizing Party over society. This entails security policies that hamper economic growth, create a chronic fear of instability, and likely jeopardize its goal to become the world's leading economy and geopolitical power.

Introductory note

The invitations to contribute to this symposium challenged participants to reflect on two alternate views of China's economic prospects: those who project its exceptional growth indefinitely into the future like one William Overholt and those who take a more skeptical view. The optimistic outlook was presumably based on my 1993 book, **The Rise of China: How Economic Reform is Creating a New Superpower**.[2] The forecast that China would become a superpower based on exceptional economic growth caused by

[1] Prepared for conference on "The Arc of Chinese Economy," Center for the Study of Contemporary China 9th Annual Conference, University of Pennsylvania, March 31, 2023 - Apr 1, 2023. The original title was "China's Long-Term Economic Prospects."

[2] William H. Overholt, **The Rise of China: How Economic Reform is Creating a New Superpower** (New York: W.W. Norton, 1993)

post-Mao reforms has been fulfilled and is a present reality. However, I have never argued that rapid growth will extend indefinitely into the future.

In fact, with that forecast fulfilled, I published another book, **China's Crisis of Success**[3], in 2018, contradicting the then-consensus expectation that China's progress would remain superior for decades. **China's Crisis of Success** argued that China was headed into a period of difficulty characterized by rising expressions of discontent, concerns about state capture, financial crises among big state-connected companies, a state financial squeeze, and suppressed but very broad elite disgruntlement. This too has been happening. Demonstrations rose by an order of magnitude compared with the beginning of this century to the point where an embarrassed Beijing stopped publishing the statistics. Conglomerates like Anbang, Fosun, HNA, and Wanda; asset managers Huarong, Cinda, and Great Wall; much of the property sector; and many others experienced financial crises[4]. Alibaba and others were clipped and their leaders sidelined for criticizing (trying to capture) government policies. The financial problems of local governments cumulated into an overall squeeze on government finances. This pattern of developments was in the 2018 book. Subsequently I have emphasized the coming economic slowdown in multiple articles.[5]

Thinking about patterns of growth

How does one make longer-run forecasts like this? I ask the reader's indulgence in an extended discussion of one way of approaching this, with examples of how I've used it. Econometric models have limited applicability because, in fast-growing economies, the economic structures change so fast and politics is so crucial. Likewise, because of the interaction of politics and economics, studies based in either of today's highly siloed economics and political science have limited value. Single-country specialists often miss what's coming, as China specialists generally did in the 1980s and early 1990s, because the insights come from observing international patterns of comparative development. However, these skills become invaluable and irreplaceable after one has a broader framework within which to exploit them.

Parenthetically, I must add that a great deal of contemporary political economy analysis is actively misleading because so much is based on a conceptually misguided focus on trying to discern broad differences between democratic and authoritarian systems—a whole literature that is effectively based on the assumption that Singapore and Somalia, South Korea and Democratic Republic of the Congo, or alternatively the U.S. and the Philippines, comprise groups that share common characteristics.

[3] William H. Overholt, **China's Crisis of Success** (London and New York: Cambridge University Press, 2018)

[4] When I speak of government-linked companies, that includes most big companies in China, not just state enterprises. Big private property companies get big because of Party or government support; nobody gets a big parcel of land and building permits and other licenses without a Party connection. A conglomerate like HNA gets its funding and its support for deals from Party bosses. Like the nominally private Korean chaebol, which under Park Chung Hee were much more tightly government-controlled than today's Chinese state enterprises, their government links are the foundation of their success story.

[5] For instance: "Thinking Through the China Hype," **The International Economy**, Summer 2022, http://international-economy.com/TIE_Su22_Overholt.pdf ; and "Xi Jinping Won't Enjoy His Third Term," **Global Asia** Vol. 17, No. 4, December 2022, https://www.globalasia.org/v17no4/feature/xi-jinping-wont-enjoy-his-third-term_william-h-overholt

What is useful is the developmental construct, a concept pioneered by Harold Lasswell.[6] Most countries fit into broad patterns of political-economic development or non-development. In a career based heavily on risk analysis, I have used such patterns mostly to discern patterns that lead to crises.[7] For instance in a number of post-colonial African countries, a government run by an urban elite of officials, intellectuals and military officers suppressed food prices in order to help their urban constituents. This led to food shortages and rural discontent, leading the government, in the interest of stability, to guarantee prices paid to farmers. Combined, these policies entailed large and increasing government budget deficits, leading the government to borrow from abroad, and later to a crisis when it couldn't service the foreign debt. Often the resultant financial crisis led to political upheaval. The inexorable financial outcome of this model did not appear in standard economic analyses of foreign reserve adequacy, debt service ratios, and the like until it was too late. If one understood the construct (or model or template) one could then use standard (mainly economic and historical) tools to build useful scenarios with specific timelines.

Closer to home for Asia specialists is a construct or model of what I call peasant democracy. Here the Philippines exemplifies the construct.[8] At independence the Philippines was ahead of every other developing country in every measure of development except (because it is a nation of islands) railroads. In peasant democracies, the institutions of U.S.-style free elections and court system have quite different consequences than in a middle class society. In a peasant society the vast majority of the population lack the resources for effective political participation; they don't have the wherewithal to organize in support of their interests and they have no money to donate to politicians. Elections then are a game within a tiny elite. Landlord groups compete and bring along their respective peasant clients, but, whichever group wins, the fundamental policies are the same: superb universities for the elite, poor education for the rest; superb hospitals for the elite, poor healthcare for the rest. Because the elite knows it will dominate, it is complacent. It doesn't give any priority to hiring the best people for efficient outcomes. It doesn't rapidly build infrastructure and it doesn't assess the taxes that would be necessary to pay for good infrastructure and broad public services. There is no sense of urgency to eliminate poverty. Rural development is neglected and comprehensive land reform is impossible; no democracy except Costa Rica has ever done an effective land reform. A complex Western court system—the

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[6] For an elaboration of Lasswell's concept, more refined than Lasswell's own articulations, see Heinz Eulau, **Politics, Self, and Society: A Theme and Variations** (Cambridge: Harvard University Press, 1986), pp. 328-334.

[7] For some of these patterns, see William H. Overholt, **Political Risk** (London: Euromoney Publications, 1982), 66ff. The comments above reflect my own history. After Brzezinski moved to Washington in 1977 I took over from him a lecture gig speaking to bankers about politics and markets. One day I got a call from a bank that specialized in cross-border lending: "Senior management has noticed that you've been able to predict crises like the Iranian revolution years in advance whereas our economists can only predict them when they're already happening. We'd like to talk to you about forming a new risk analysis group." That group came to be perceived as the leader in the field, so Euromoney commissioned me to write the first book about political risk analysis. The availability of Lasswellian frameworks actually enhanced the value of professional economists and the use of them expanded. In contrast, an early 1980s wave of hiring political risk analysts quickly receded because academic political science provided few useful tools and those (Gini index/political discontent) were heavily borrowed from economics and employed crudely. The obsessive but futile effort to discern broad differences between democratic and authoritarian systems in meritocracy, long-range planning, growth rates…has ensured that much of contemporary political science continues to be irrelevant, not to mention wrong.

[8] This brief sketch of a model adapts the findings in William H. Overholt, "Duterte, Democracy, Defense," Brookings Institution, January 2017, https://www.brookings.edu/research/duterte-democracy-and-defense/

Philippines had by far the most sophisticated judicial system in the developing world--greatly exacerbates elite-mass divisions because the majority of the population can't understand the system and certainly doesn't have the resources to hire a lawyer.

In such a system development lags. The Philippines went from being the region's most developed to one of the least developed. People love elections but hate the social outcomes. In response, a small minority joins communist or separatist or Islamist insurgencies. The majority increasingly support leaders who promise drastic change at the expense of democratic norms—Ferdinand Marcos who promised to emulate South Korea, his assassinated opponent Benigno Aquino who idolized Park Chung Hee, corrupt womanizer and movie actor Joseph Estrada, thug Rodrigo Duterte, Bongbong Marcos. Duterte, who slaughtered thousands of people and suppressed opposition media, was the most popular president in Philippine history by far and, after his murderous pattern was well established, his followers swept the next legislative election in a landslide. India follows a version of this pattern. Initial development parity with China led to drastic decline in relative GDP. Horrible health, education and poverty outcomes have eventually led to majority support of a ruthless undemocratic figure, Modi, who suppresses freedom of the press, oppresses opposition groups, tolerates or encourages violence against Muslims, represses Kashmir much as China represses Tibet, and has managed to expel his principal political opponent from the legislature, but above all promises to impose change and ignite growth.

In contrast, China has emulated the so-called East Asian development model (based on the "little dragons," South Korea, Taiwan and Singapore)[9] that initially shared key characteristics, including:

- An order of priorities: agriculture, light industry, heavy industry, domestic politics, international politics, the exact opposite of Soviet priorities, as I emphasized in **The Rise of China** and earlier articles.
- Intense fear of national catastrophe—South Korea after the Korean war, Taiwan after China's civil war, Singapore after brutal separation from Malaysia, China after the Great Leap and the Cultural revolution—leading to national mobilization, characterized by:
- An overwhelming priority for economic growth.
- Highly centralized economic management.
- Authoritarian political control, used to implement policies that would otherwise have been politically unfeasible or unacceptably delayed (e.g., Taiwan and South Korea land reform, Park Chung Hee's diplomatic rapprochement with Japan, China's 1994 tax reform, Zhu Rongji's forcing GITIC to accept bankruptcy, the Jiang Zemin/Zhu Rongji post-1998 military enterprise reform that would have been impossible in Indonesia or Thailand).
- Marxist-Leninist ideology, in various forms and varied degrees of explicitness.

[9] Nearby countries such as Thailand, Indonesia and Malaysia share some diluted characteristics of the Asian Miracle economies and have achieved proportionate success with proportionate problems. They are effectively hybrids between the Asian miracle model and the peasant democracy model. India, Sri Lanka, Brazil and a good many others fit the peasant democracy model. Until the late 1990s Thailand was a hybrid that developed very rapidly from a base as one of Asia's poorest countries. Later it became a caricature of an electoral oligarchy alternating with a self-serving military government.

- Technocratic, meritocratic institutions (gaokao, merit promotion, think tanks that bypass the inertia of the bureaucracy and train an elite of future top officials).[10]
- A high degree of initial egalitarianism--e.g., land reform, rural development programs, mass education—and intense efforts to reduce absolute poverty.
- A gradual opening of the economy to domestic market forces and to international trade and investment.
- Intense competition.
- An emphasis on building infrastructure beyond what Western development institutions consider prudent. (See the Seoul-Pusan highway, rejected by AID and the World Bank, subsequently the backbone of Korean development; periodic Taiwan railroad building plans….)

The construct itself does not provide a forecast. It provides a context for exploration of the extent to which China is likely to follow or deviate from the pattern.

These systems typically experience a generation of extremely rapid growth, typically near 10 percent annually, and then come to a crisis of success that occurs because easy wins are exhausted, bubbles develop, and rapid growth transforms a relatively simple economy and society into a very complex economy and society. The latter, which I call a complexity revolution, renders centralized, hierarchical economic and political control more difficult. Taiwan had its 1979 Kaohsiung riots and much later the financial crisis of the 40 Guomindang-owned infrastructure conglomerates. South Korea in 1979 experienced an explosion of national inflation and foreign debt, a financial crisis of the chaebol, and the assassination of Park Chung Hee. It took a decade or more for those countries to accommodate a newly complex economy and society by moving to more market-oriented economic and political management.

China is now in the midst of parallel crisis of success but is attempting to manage it by suppressing complexity and centralizing further.

Once the developmental construct is explicit, then all the specialist skills of the economist, the political scientist, the historian, the country specialist, become not just useful but essential. To what extent are economic, social and political trends consistent with the template? In what ways are these trends different? What modifications of a prediction do those differences entail? This is where the detailed work occurs. To establish that China fit the growth template of the little dragons was the subject of my book, **The Rise of China: How Economic Reform is Creating a New Superpower** along with numerous

[10] There has been regrettably wide acceptance of an argument that China's promotion system is not (relatively and with some flaws) meritocratic. This is largely based on a regression analysis that applies an inappropriate method to an invalid dataset and then amplifies the findings with a fallacy of division. See Victor Shih, Christopher Adolph and Mingxing Liu, "Getting Ahead in the Communist Party: Explaining the Advancement of Central Committee Members in China," **American Political Science Review** Vol. 106, No. 1 February 2012; Victor Shih's work in the special issue on China of the **Journal of East Asian Studies**, Volume 16, Special Issue 01, March 2016; and my critical analysis **in China's Crisis of Success,** pp. 176-188. Of course, Xi Jinping has subsequently weakened meritocracy. For evidence that meritocracy increases growth, see Hongbin Li and Li-An Zhou,"Political turnover and economic performance: the incentive role of personnel control in China,"
Journal of Public Economics, Volume 89, Issues 9–10, 2005,
https://www.sciencedirect.com/science/article/pii/S0047272704001355

articles.[11] To establish that it fit the template of their crisis of success was the subject of **China's Crisis of Success**. Those forecasts have worked. What of the future?

The growth pattern of the Asian miracle economies

The little dragons typically grow at about 10 percent per year for a generation, then slow to 7 percent for a few years, then settle down to about three percent. (South Korea from 2001 t0 2015 was 2.85 percent.) Will China follow this pattern? It has so far generally tracked the overall pattern in terms of economic growth rates and is now experiencing the first deceleration. However, instead of accommodating the complexity revolution China is fighting it. It is trying to push back the tide rather than channeling it. We know from watching South Korea, Taiwan and Singapore that political and economic accommodation (elections, market pricing, competition, acceptance of most market outcomes, openness) are conducive to subsequent high incomes, high technology and social stability. China's fundamental divergence from the accommodation model is obviously crucial. Exploring the details of this decisive break from the earlier pattern, the basic shape of China's economic growth curve will remain similar but most aspects of the "fighting complexity" strategy will further depress growth.

China's economic aspirations and policies have evolved rapidly. What has remained constant for centuries is a determination to return to the domestic wealth and international power that most Chinese view as the only acceptable norm for a civilization that long led the global economy. Comprehending the continuity of this deep aspiration is essential when later we consider the long-term prospects of the Xi Jinping approach to management.

Under Deng Xiaoping and Jiang Zemin (1978-2003) the leadership's model of how to achieve that evolved rapidly in the direction of market-oriented reform and international opening to trade and investment, along with political and administrative institutionalization, meritocracy, and increasing differentiation among Party, government, and markets. Under Hu Jintao (1993-2003), economic reform and opening as previously understood largely stagnated; that administration's achievements focused on elimination of some unfair treatment of farmers, spreading the economic miracle to China's interior, and surviving the 2008 Global Financial Crisis. However, Hu's administration also included significant efforts to institutionalize governance, including collective leadership, enhanced meritocracy and increased intra-Party democracy, and experiments with local democracy. Hu's legacy included these achievements but also worsened problems of coordinating parts of the central government, dissonance between the central and local governments, and a spectacular increase in the visible scale of corruption. Many of Hu's colleagues saw all these, including the governance changes that appeared to Western observers to be important steps forward, as threats to Party rule. Hence they chose a successor, Xi Jinping, who was determined to consolidate Party rule, impose stability, and reduce corruption.

[11] Among many, see "The China Model," **Fudan Journal of Humanities and Social Sciences**, June 2011, pp. 1-18, originally a paper presented at the World Forum of China Studies, Shanghai, November 6-7, 2010, sponsored by the Shanghai Academy of Social Sciences and Fudan University. It became clear at that Forum that, surprisingly, most Chinese scholars initially thought the China model was unique and didn't realize the extent to which Deng Xiaoping had emulated the earlier Asian successes. Deng asked the question, why are our neighbors doing so well while we are doing so poorly? Then he followed through very decisively on the answer.

China's changing view of the Western model

Until the mid-2000s China looked up to Western economies and Western polities much as South Korea, Taiwan and Singapore did. That absolutely did not mean that they intended detailed copying of them, but they saw them as models of how both mature economies and mature polities work. They took most World Bank advice. They imported Hong Kong officials wholesale in the belief that Hong Kong's market-friendly structure provided a primary economic model for China. At the turn of the century the Central Party School under Hu Jintao was working on three models for democratization, including one modeled on Japan (elections mainly influencing the balance among factions within a dominant party) and one on Taiwan. At a RAND Corp. conference in November 2001, during a debate about Taiwan, the political leader of a Central Party School delegation surprised the Americans by declaring, "We hate everything Lee Teng-hui is doing in cross-Straits relations, but we admire the way he has taken Taiwan politics to a new level." The Carter Center and the International Republican Institute were advising on village elections. There was even high-level discussion of whether Taiwan's Guomindang Party might one day be allowed to compete and win and election in China's Fujian Province.

Three things changed that reverence for supposedly more mature Western models. The Global Financial Crisis of 2008 shocked and damaged China and convinced officials there that the Western model of economic management was fatally flawed. The emergence of Donald Trump and Boris Johnson, along with regional examples like the Philippines and Thailand, reduced to absurdity, in their view, any argument that Western democracy would ensure governance in the interest of the people or the power of the state. And China's own positive experience of mobilizing state-controlled institutions to overcome the 2008 financial crisis convinced a working consensus of China's leadership that state control of the financial system and the pinnacles of the industrial economy was essential. (In a crisis such controls are indeed valuable, and even the most capitalist Western economies rebalance in favor of central controls in times of war or other crisis. The problem with the conclusions many Chinese leaders drew about the superiority of centralized, state-led economic management is that, of course, most of the time economies are not in crisis.)

The combination of domestic insecurity and disillusionment with the Western model led to the selection of Xi Jinping and likeminded colleagues with a mandate to suppress internal dissent, overcome fractiousness within the central government, consolidate the center's control of the periphery, and crush corruption.

China's new economic model

Under Xi Jinping China seeks to create a new system with extremely centralized executive leadership of the government and state enterprise leadership of the economy while retaining the full benefits of market competition. It wants to strengthen the state enterprises while retaining the benefits of a private sector that provides 90% of urban employment, 100% of net job creation, over 50% of exports, and, according to former Vice Premier Liu He, more than 70% of all innovation. Likewise it wants to retain the advantages of foreign direct investment while preventing foreign companies from attaining a leadership role in any Chinese sector and achieving Chinese global dominance in every aspect of modern manufacturing.

In this new system[12], state enterprises will control the commanding heights of the economy. The government will support the private sector, but every company will have a Party Secretary with ultimate decision power over strategic business decisions and every company will eventually have at least a small but controlling "golden share" of government ownership in a form that ensures the state's ability to monitor and correct socially inappropriate decisions. Chinese companies will attain dominance of advanced manufacturing in foreign countries, but foreign companies will never be allowed to dominate any important sector in China. The education system will be remodeled and shortened to rigorously support industrial needs.

Along with stability, the overarching theme of Xi Jinping's new model is "Common Prosperity," and the core promise of Common Prosperity is a fairer system without the divisive income and wealth inequality that currently plagues both China and the United States.

This is an inspiring wish list—as socialist critiques of capitalism and promises a century ago were inspiring. Actual policies are accomplishing much that Western-style democracies currently seem incapable of implementing, such as rapidly eliminating extreme poverty and making exceptionally rapid progress on green energy. But it is also a wish to have one's cake and eat it too. Foreign companies and countries will reject a system where they are lured in for their technology but excluded from the kind of market access that China demands from the West. Xi Jinping's support for the private sector is sincere, but no matter how many times he tells the big Beijing banks to lend more to private companies they still will never get their money back if they obey. (If the bank doesn't have deep roots in the local village, wily locals walk away with the bank's money. Then bank executives are punished, sometimes severely, when the money doesn't come back.) Subsidized state enterprises eat up the private ones. Private sector investment and growth have plunged.

The extensive political controls on business will either be costly or ineffective. Of course, we do not yet know, for instance, how the relationship between the Party Secretary and the CEO will evolve. China's diversity means that evolution will almost certainly be diverse. We do know anecdotally that among the big companies in Beijing the Party Secretary and the CEO often have quite different agendas; that outcome will impede growth. It is reasonable to hypothesize that in Guangdong the CEOs will often coopt the Party Secretaries, lucratively. More broadly, the role of the Party Secretary could become like a super-CEO or Board Chair in some cases and elsewhere more like an analogue of a Western bank Compliance officer. Such roles will probably be beneficial in some cases (a U.S. government compliance officer on the board of Silicon Valley Bank might have averted a crisis), but on average it will likely be a net cost.

The intended insertion of political commissars, who will have veto power over strategic business decisions, into all enterprises is a microcosm of two broader trends: a shift in the balance between red and expert (political loyalty vs. technical skills) from an emphasis on expert to a priority for red; and a blurring of the differentiation, carefully cultivated by preceding reformist leaders, among Party,

[12] For a description of the recent evolution of China's state investments and political controls on the economy, see Chen, Hao, Rithmire, Meg, "The Rise of the Investor State: State Capital in the Chinese Economy," **Studies in Comparative International Development 55**, 257–277 (2020). https://doi.org/10.1007/s12116-020-09308-3; and Pearson, Margaret M; Rithmire, Meg ; and Tsai, Kellee S., "China's Party-State Capitalism and International Backlash: From Interdependence to Insecurity," **International Security**, 2022, Vol.47 (2), p.135-176, https://muse-jhu-edu.ezp-prod1.hul.harvard.edu/article/880543

government, and business. That blurring reduces the cultivation of specialized expertise and clear focus in each function.

Barry Naughton[13] has emphasized a related shift under Xi Jinping, away from a sharp focus on economic growth to a more diffuse set of goals that include, security, growth, distribution, and a broad set of structural goals. Much of this shift would happen anywhere as development continues. When a family has enough to eat, its goals broaden. When a society has successfully provided adequate food and shelter, its goals broaden in synch with its families. But in Xi's China the inevitable blurring of focus occurs in the context of Xi's broader blurring of boundaries and dilution of specialization. Moreover, as Naughton highlights, Xi's centralization diminishes the provinces' and cities' ability to make decisions based on their refined understanding of local conditions; this reverses Deng Xiaoping's deliberate and fruitful decentralization.[14]

Moreover, the centralization and blurring of boundaries naturally inflate corruption. While Xi Jinping has waged a valiant and politically costly war against corruption, highly centralized and hierarchical economic systems breed corruption the way a wet log breeds mushrooms. The blurring and politicization of responsibilities magnify that effect. In the days of Mao and of early reform, an official was often simultaneously the author of steel industry regulation, the implementor of that regulation and owner of a steel factory. Today Party/government ownership of land, while simultaneously being beneficiaries of land sale revenues, regulators of land uses, and decider of who gets use of a particular parcel, invites corruption. When reformers created clear divisions of labor among Party, government and business, such incentives to corruption declined. Now they are being reintroduced. No anti-corruption campaign is as powerful as the structural incentives the Xi administration is enhancing.

As it centralizes and emphasizes the leading role of the state enterprises, Xi's administration seems to have forgotten one of the central lessons of socialism's history: political leaders believe state ownership will give them control of the economy, but the big companies inexorably end up owning the politicians.[15] This is already happening, for instance in healthcare. Government policy is that resources should increasingly flow downward, to the local primary care level. However, huge, powerful state-owned hospitals drive the flows increasingly upward to themselves.[16] Something similar may be happening in banking. Alibaba's brilliant use of data to analyze credit instantly and make immediate decisions was disintermediating the banking system, making finance much more efficient at the cost of weakening the big state-owned banks. These giant institutions resisted the onslaught of Alibaba and others and that seems to have contributed to the decapitation and dismemberment of Alibaba and the nationalization of its database, which was then provided to the big banks.

The German education and apprenticeship model, which Xi seems to be emulating, deemphasizes broad education in favor of a higher priority for vocational training. This provides immediate advantages for

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[13] Barry Naughton," The 'Summer of 2021' and the Trajectory of the Chinese Economic System," conference on "The Arc of Chinese Economy," Center for the Study of Contemporary China 9th Annual Conference, University of Pennsylvania, March 31, 2023 - Apr 1, 2023

[14] Se Jean Oi, **Rural China Takes Off: Institutional Foundations of Economic Reform** (Berkeley CA: University of California Press, 1999). On the flowering of local initiative that occurred, see Kate Zhou, **How the Farmers Changed China: Power of the People** (Boulder CO: Westview Press, 1996). Zhou and others rightly highlight the importance of local initiative but disregard the crucial leadership decision to accommodate and then encourage that initiative—unlike Xi Jinping.

[15] See Ralf Dahrendorf , **Class and Class Conflict in Industrial Society** (Stanford: Stanford University Press, 1959).

[16] On this point I am indebted to a presentation by Winnie Yip of the Harvard School of Public Health to Harvard Fairbank Center's series on Critical Issues for Contemporary China, March 29, 2023.

current industry, but it decreases long-run flexibility. It has largely confined the German economy to refining early 20th century technologies like the automobile while the U.S., which emphasizes providing a broad education, dominates the modern service economy.

The Beijing administration is imposing this new system, or important parts of it, in the context of the weakening of the core drivers that have driven China's exceptional growth, along with emerging drags on growth. More on this below.

The social program

From the era of the Chinese civil war through the early times of Mao's leadership, the Chinese Communist Party has branded itself as egalitarian. China's constitution specified an economically egalitarian political process based on struggle by peasants and workers against their erstwhile social betters. The early years after 1949 were noteworthy for a violent egalitarianism: land reform and the Three and Five-Anti campaigns that dispossessed business leaders. Deng Xiaoping, however, proclaimed that in the interests of growth some people must get rich first. Jiang Zemin dispensed with the constitution's emphasis on class struggle and instead promoted the ideal a vanguard cultural and economic elite. Hu Jintao sought to moderate the ensuing explosion of inequality by emphasizing rural improvement, but his era was nonetheless marked by the congealing of a wealthy, powerful, corrupt Party-government-business privileged class.

In this context Xi Jinping seeks to revive the Party's egalitarian credentials. He famously completed the drive to eliminate "absolute poverty," but absolute poverty was defined as such a low hurdle that it left hundreds of millions in poverty that was quite severe even if not quite absolute. Rural education remained below standard for China's level of development[17] (albeit far above once-equal India). Rural health institutions remain absolutely poor. The hukou system deprives many of vital social services when they have moved to the cities in search of a better life. Pensions, health insurance and care for the aged remain quite backward. Resources have gone to the cities, the elite, national grandeur, and the vast and vastly expensive domestic security and political control service.

Most importantly, Xi Jinping has sought to revive the Party's egalitarian brand by assembling egalitarian policies and programs under the brand of "Common Prosperity." Many policies are variations on earlier programs: helping poorer areas with transfers of income and industry, adjusting tax rates, improving social services, boosting certain kinds of education, adjusting minimum wages including for gig workers, and making special efforts to improve rural life. The novel policies include campaign-style tools: decapitation of the high-flying tech companies, breaking up Alibaba, forcing the wealthy to make large charitable donations, and the like. And they include policies that greatly enhance the power of the state, most notably nationalizing the databases that made Alibaba and Didi so efficient. These policies have been vastly destructive of wealth and have crimped China's extraordinarily successful tech sector. These consequences have led MIT's Yasheng Huang to speculate that the real purpose of the novel policies is to crimp the economic and political power of private capital.[18] Certainly that is at least one motivation, as seen by the treatment of Alibaba's leader Jack Ma, who went from being the country's economic superhero to a couple years of exile in Tokyo after having the temerity to criticize banking regulators.

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[17] Scott Rozelle and Natalie Hell, **Invisible China: How the Urban-Rural Divide Threatens China's Rise** (Chicago: University of Chicago Press 2020)

[18] Yasheng Huang, "The Political Economy of Common Prosperity," paper for conference on "The Arc of Chinese Economy," Center for the Study of Contemporary China 9th Annual Conference, University of Pennsylvania, March 31, 2023 - Apr 1, 2023.

While decisions in the name of Common Prosperity programs have imposed trillions of dollars of lossess on market values and crimp the most dynamic parts of the economy, they do not include the politically difficult measures that would actually shift the economy sharply toward the fairness promised by the "Common Prosperity" slogan. That would ultimately require a substantial property tax, a highly progressive income tax, termination of the controls on rural migration to the cities, greatly liberalized rural land rights, and a shift in the balance of taxing power between the center and the localities. At least some crucial fairness policies seem politically beyond Xi Jinping's reach. Eleven years of high-level conversation about the needed property tax have failed to implement even an experimental version. Most of the Party-government-business elite's wealth consists of property holdings and that elite has a strong interest in resisting taxation of it. In many cases, there is an even stronger interest in refusing disclosure of holdings.

Ultimately Xi Jinping and Joe Biden appear equally impotent to alter their countries' egregious maldistribution of wealth. Ultimately both have chosen security and geopolitical glory over amelioration of serious domestic social problems. In China's case this is particularly egregious because the combined costs of the military and the vast domestic security apparatus are exceptionally high while hundreds of millions of people remain desperately poor.

China's long-term economic prospects

All these developments tend to reduce growth. Ironically, just as triumphalism is fading in China, a version of China triumphalism continues in the United States. Many commentators, particularly those associated with the U.S. Defense establishment, project superior Chinese economic growth indefinitely into the future[19] and infer that China will overwhelm the U.S. This assumption is the foundation of status panic over China in Washington DC. Such commentators assume that superior past Chinese growth implies superior future Chinese growth—an assumption scholars can seemingly get away with even if stockbrokers are required to disclaim such inferences.

In fact, the drivers of fast growth are fading. A surprising amount of higher level "Chinese" manufacturing is actually foreign companies' production based in China. The technological progress of many Chinese industries has relied on collaboration with foreign companies that are becoming disillusioned with unfair Chinese practices.[20]

Historically the U.S. overestimates its competitors and underestimates itself. Throughout the Cold War Americans (intelligence agencies, economists, media opinion makers, and informed public opinion) egregiously overestimated the Soviet economy. In the 1970s and 1980s they grossly exaggerated Japan's prospects. Most recently we have grossly overestimated Russian military capabilities. Discussions of China do not seem to have digested the lesson of these failures.

One way the prowess of Japan, the Soviet Union and China has been exaggerated is to focus on manufacturing prowess and ignore the service economy, which is larger and more important than manufacturing even in China. (In 2015 the services sector grew to 50.5 percent of China's economy and subsequently has continued to expand.) While the opening of China's manufacturing sectors to foreign investment, together with Chinese companies' competition for overseas markets, has toughened China's

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[19] For instance, Graham Allison, Nathalie Kiersznowski, and Charlotte Fitzek, "The Great Economic Rivalry: China vs the U.S," Harvard Kennedy School Belfer Center, March 2022, GreatEconomicRivalry_Final.pdf (belfercenter.org)

[20] On the crucial role of foreign direct investment, see Michael Enright, **Developing China: The Remarkable Impact of Foreign Direct Investment** (New York: Routledge, 2016)

manufacturing through competition, the services sector has remained relatively closed and uncompetitive. Hence U.S. dominance of services will likely persist in an era where both economies are dominated by service industries. Moreover, it is important to remember that, in addition to being the biggest part of both economies, services are crucial to long-run innovation and vitality in manufacturing.

Within services, education and scholarship are particularly important. The government has banned for-profit private education. Official incentives to learn English have declined. In Silicon Valley, and implicitly in Western university research, the ultimate goal is a *disruptive* breakthrough, but in China university research funds are channeled through Party Secretaries, who are selected for devotion to stability rather than for enthusiasm about disruptive ideas. Professors' and students' travel abroad, communication with foreigners, and access to information have been restricted. Political controls on curriculum and teachers have increased at all levels. Foreign scholars' access to information and to discourse with Chinese colleagues has been even more restricted. The use of Chinese students abroad as spies—on their colleagues, on foreign professors—and the willingness of a few to threaten people who disagree with them are raising questions in foreign universities about the cost of welcoming large numbers of Chinese students. The impact on future economic progress of this deteriorating environment is impossible to quantify, but it is not positive and it is not zero.

The core drivers of China's "miracle" growth have been heavy infrastructure, property development and urbanization. By the end of this decade those drivers will be largely exhausted. Property already shows signs of plateauing or tipping over. Throughout China one encounters infrastructure projects that will never pay their way; drive across impoverished Anhui province and the wide, first-class highways will surprise anyone from potholed Massachusetts where I live. Urbanization still provides some growth, but by the end of this decade it too will be largely exhausted. Moreover, the easy phase of technological catch up is over. The slowing effect of a more difficult phase of technological catch up are magnified by Western governments' and companies' pushback against intellectual property theft and foreign investors' reaction against unfair regulation and limitations on their market shares. If China were to follow the pattern of the East Asian model construct, its potential growth should decline by decade's end to about the 3 percent that have been typical of South Korea, Taiwan and Singapore. But all the additional drags imposed by the Xi Jinping administration's political controls, its fighting against the complexity revolution, should detract substantially from that 3 percent, perhaps comparable to the current U.S. level of 2 percent or below.

Property and infrastructure have gone beyond drivers to become bubbles. The property bubble has at least partially burst. While that bursting appears more manageable than its counterparts in Japan and the U.S., because China's banks are proportionately far less exposed, it leaves behind large debts that must be serviced over an extended period of time. Moreover, it creates a financial squeeze for local governments throughout China that are more dependent on property development income than their Western counterparts. Less obviously, the same is true of infrastructure. Amortizing China's wondrous railroads was always going to be a serious burden; as the economy slows, as local governments increasingly lack the wherewithal to fund construction of their segments and to service the railroad construction debts, growth will slow proportionately. Maintenance of all that wonderful infrastructure will be like an additional debt burden; when it is still new, maintenance costs are low but later they rise. If anecdotal evidence of inferior construction and use of substandard materials proves indicative of widespread problems, those maintenance costs could be very high.

The heavy political controls that Xi is imposing will, if they persist and are strongly implemented, slow growth. Officials' innovative entrepreneurship at all levels has been a crucial source of growth. That has been a crucial engine of China's growth. Recall that when the central government restricted local government revenues but gave them the right to create companies, almost overnight town and village enterprises were employing 110 million people. Under Xi's tight controls, that entrepreneurship has largely died. Successful local entrepreneurship used to include bending or bypassing the myriad rules; if a local official met his or her goals, few questions were asked about how that was achieved. There were so many rules that movement required infringing some of them. Now, however, everyone is terrified to act; breaking any of the gridlocking makes one vulnerable to accusations of corruption. The result is that China's sprawling Party and government bureaucracies often resemble a New York City subway work to rule—a form of strike.

A banking system that has become much more centralized and hierarchical cannot adequately service the private sector economy that provides most economic growth, all net new jobs, and most innovation. Liu He has argued that innovation will replace the old drivers and anyone who visits Shenzhen or Zhonguancun will be dazzled by the innovation energy. But on balance across China the political controls, emphasis on state enterprise control of the commanding heights of the economy, and the collapse of private sector funding and investment will hinder innovation.

China's economy has for decades displayed a remarkable imbalance. Household incomes are proportionately very low. Investment is very high, in fact so high that its egregious scale makes consumption look much more inadequate than it is.[21] More broadly, Chinese economic policy has had a one-sided emphasis on improving the supply side of the economy rather than the demand side. In 2013 Premier Li Keqiang supported a plan to emphasize boosting the demand side of the economy, a balanced approach the came to be called Liconomics. But Xi Jinping overruled him, eventually subordinating the prime minister's normal authority over the economy to Xi's expanding reach, and ensured continued emphasis on upgrading the supply side, especially infrastructure and advanced manufacturing. This imbalance continues to be a drag on the economy.

Moreover, just as Xi's policies are fighting the complexity revolution, they fight other inexorable economic tides. Xi (here sounding like Biden) wants to prevent decline of the share of manufacturing in China's economy.[22] He and other officials laud the private sector but impose a centralized banking system that cannot support it. XI thinks hardware is much more important than software. He wants innovation, intended to be the main engine of future growth, to be driven by top-down directives and subsidies, but historically China's great innovations have come from the bottom up. The genius of China's leadership has been, not to impose innovations from above, but to incentivize innovation from below and to wisely endorse spontaneous innovation from below, even when that innovation contradicted official policy. Most notably, when farmers started taking their land back and reverting to family farming, the leadership recognized an economic and political opportunity rather than suppressing the infringement of socialist collective production.

This collection of depressive trends and developments lies behind the collapse of total factor productivity that has already occurred. A World Bank study[23] has calculated a two-thirds decline of China's total factor productivity growth. Xiaodong Zhu[24] has calculated that from 1978 to 2007 China's

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[21] Guonan Ma, Ivan Roberts and Gerard Kelly, "A Rebalancing Chinese Economy: Challenges and International Implications," Reserve Bank of Australia Conference Volume, 2016, https://www.jstor.org/stable/j.ctv5cgbnk.19
[22] Naughton, op. cit., makes this point.
[23] Loren Brandt, John Litwack, Elitza Mileva, Luhang Wang, Yifan Zhang, and Luan Zhao, "China's Productivity Slowdown and Future Growth Potential" (Washington DC: World Bank, 2020)

[24] Xiaodong Zhu, "China's Productivity Challenge," conference on "The Arc of Chinese Economy," Center for the Study of Contemporary China 9th Annual Conference, University of Pennsylvania, March 31, 2023 - Apr 1, 2023

total factor productivity grew at 4 percent, driven by domestic market reform, international opening, market-based technological diffusion and innovation, and reduced barriers to internal trade and migration. Crucial to this rapid growth of productivity was innovation that bubbled up from society [and leadership willingness to endorse that innovation]. He finds that capital reallocation and export expansion have contributed little to that amazing growth. Recently the most productive kinds of reform have lagged and Xi Jinping has emphasized tight controls and top-down innovation, so total factor productivity growth has collapsed to 1 percent. Thomas Rawski notes the China's productivity growth has dropped earlier in the cycle than it did in the little dragons.

In China's graying society, the number of working age people started declining in 2015 while the welfare burden of caring for the aged is increasing. The Japanese experience shows what an extraordinary burden a graying society can be. China's graying problem is worse.

China will have some wins

China has some important positive trends and opportunities. It looks set to dominate green energy technology and production of electric vehicles. Contract manufacturing of gene and cell therapies may become a very large and profitable sector, and China could be the world's leader. Rural reform, including education and removal of the hukou system, could yield large gains. Some room remains for technological catch up. If China can find a way to satisfy tech regulatory needs and release once again the energy of its tech companies, Alibaba, Tencent and Didi, which were far in advance of Western competitors, could resume their success. There could be many more like that.

It is more difficult to identify areas of potential breakthrough than to see looming problems, so failure to imagine areas of upside potential is a source of risk in projecting the future.

Budget sobriety and sand in the gears

China is also adjusting to the end of a bull market, and a bull market mentality, in government budgets and their management. For decades of the reform era, GDP grew fast and central government revenue grew twice that rate. Double growth of revenues occurred because the economy was increasingly monetized and tax collection was improving. This created the illusion in Beijing and abroad that the Chinese government had unlimited resources. Now GDP grows more slowly and government revenue growth must converge with GDP. The slowdown of property development severely crimps local government budgets. The severe belt-tightening of the Belt and Road Initiative, and the debt problems resulting from its early extravagance, are among the many indicators of incipient sobriety.

During Xi's third term, the controversies over Covid-Zero, Russia, decapitation of the big platform companies, political controls on the economy, private sector malaise, severe political repression, and extreme decoupling of Chinese elites from global society will be sand in the gears of the economy for his five-year term, possibly followed by a historic succession struggle.

Alternative scenarios

To summarize, China's trajectory roughly follows the template of the smaller dragons, for similar reasons. Given its loss of powerful drivers and its demographic problems, China's potential growth after 2030 is probably similar to the little dragons (3 percent) or to the U.S. (2 percent). Xi Jinping's overcentralization, Japan-style industrial policy, kneecapping of the private sector, and political controls will probably reduce growth substantially below its potential.

As we look out to the future, even if the current structures and policies of the Xi Jinping era remain relatively constant, there are many sources of uncertainty. We don't yet know the rough magnitude of

China's debt or the rough magnitude of infrastructure maintenance costs. Judgments about China's ability to innovate can be informed, but ultimately they are guesses. We don't know whether there will be a pandemic or a catastrophic banking crash or a disabling succession struggle. We don't know whether there will be a great technological breakthrough or a resource discovery in China's favor. A move away from overcentralized finance, toward a system that could more effectively finance local private enterprises, could make a large positive difference. The general shape is important, worth debating, and should be about right, but it is still just a general shape.

The greatest uncertainty is the evolution of the U.S.-China relationship. It could become more constructive if both sides react against the looming dangers of confrontation. It could descend into economic warfare. At worst, there could be a real war—limited war over Taiwan, which would itself be economically devastating, or warfare not geographically confined.

Japanization?

In **China's Crisis of Success**, I highlighted the risk of Japanization, which is a slowing of development caused by a coalition of traditional industrial conglomerates and politicians that inhibits reform, competition, innovation and internationalization. This would imply a GDP growth rate of 1.5 percentor less. Xi Jinping has heightened the risks through: wanting the core of the Chinese economy to be dominated by a group of big state firms; expecting innovation to come heavily through subsidies to those firms; giving a Party Committee veto over strategic business decisions in every firm; consolidating bank finance in giant firms that cannot fund local private firms in a creditworthy fashion; immobilizing a previously innovative state/Party bureaucracy through omnipresent fear of politically tinged accusations of corruption; seeking industrial self-sufficiency; giving control over allocation of research funds to Party secretaries whose interest is the opposite of disruption; inhibiting scholarly exchanges with the foreign world; reducing the educational and career value of learning English; and more broadly fighting against some of the most powerful tides of economic and social development.

China retains key advantages. China has facilitated the emergence of innovative SMEs whereas Japan has inhibited them. China has facilitated the social transformation from a manufacturing economy into a services economy whereas Japan's giant industrial conglomerates have the political clout to slow that transformation. Chinese society has remained far more outward-looking than Japan's. Frustrated, ambitious Chinese students go abroad; Japan's stay home. Chinese scientific scholarship is competitive and internationally collaborative in a way that Japan's isn't. Chinese elites speak English (and other languages) and thus have access to foreign ideas to an extent that Japanese counterparts don't. China's economy is open to GM and thousands of other foreign firms on both the supply and demand sides to a degree that Japan's isn't. Despite Xi's changes, these advantages remain strong.

But Xi has put crucial Chinese advantages at risk. One of China's greatest advantages has been its adaptability. Each leadership team (Mao/Deng/Jiang/Hu/Xi) has changed the country's politics and economics drastically to correct the failings of its predecessor. Xi has interrupted that process of change and correction, but we do not yet know whether he has curtailed adaptability or just interrupted it temporarily. Another Chinese advantage has been the sense of mobility, of everything getting better for everybody. Japan had that through the 1980s, but then decades of near-stagnation imbued Japanese youth with hopelessness; why venture abroad or aspire to disruptive innovation when one's whole life experience is deadening? China is now where Japan was in the 1970s. As China's growth becomes slow, as the Party elite congeals, as fear quiets the intense debates about everything that have characterized Chinese society, the risks of Japanization will grow.

The Chinese response to economic and scholarly deadening is the opposite of Japan's. The Japanese stay home and don't sally abroad in search of greater opportunities. In contrast, most Chinese middle class and elite families want their money, their children and often themselves out of China. Beijing risks losing its most creative minds and business ideas through repression in a way that Japan doesn't, but the Chinese exodus also feeds a vast global feedback loop that historically has facilitated revitalization. We are still in a long cycle whose early phase was driven by expatriate Sun Yat-sen. China's great economic takeoff of the past four decades is part of a shorter cycle driven by Deng Xiaoping's awareness of the four little dragons' successes together with the capital, business acumen and money of Hong Kong, Taiwan and the overseas Chinese networks.

If we extrapolate the trends of Xi Jinping's era indefinitely into the future, Japanization is coming. But, despite its size, China changes more readily than Japan does. China's diversity and its overseas networks fuel other scenarios. Every Chinese grad student I encounter speaks of the risk of Japanization; that self-awareness is itself powerful.

Structural change?

Prediction about China's future economic path carries far more structural uncertainty today than in the 1980s and 1990s. There was a great facilitator for predictions about China's growth to superpower scale back in the 1980s and 1990s: In a society desperate for the basics of life, food, shelter, education, the reform and opening policies led to income growth for every social group. This naturally generated broad support for those policies. A political-economic virtuous circle developed. This was obvious in China at the time, and it had been clear in the experience of the smaller dragons.

On the contrary, policies that, in the name of security, worsen a decline of growth do not create such a virtuous circle. They are politically self-undermining. Moreover, a declining growth rate is not China's only political problem. As I documented in **China's Crisis of Success**, across all the important Chinese elites many forms of suppressed discontent fester. There is an incentive to change. That does not make positive change inevitable. It means repression and the economy will either get much worse or much better, not remain the same. This is itself is an important point, because there is a tendency in the U.S. to assume that China tomorrow will be basically the same as China today. Indeed, there is a strong tendency to argue that, really, China since 1949 has always been structurally the same, that Xi Jinping's China was always immanent in Deng's China and Jiang's China.

That image could hardly be further from the truth. For such a large country China's many changes are extraordinary. As noted earlier, each leadership team has sought with considerable success to decisively correct the weaknesses of its predecessor. Deng shed Mao's autarky, collectivization and suppression of the market. Jiang repudiated peasant-worker struggle against the elite as the core political strategy and substituted an emphasis on inclusiveness, shared interests and vanguard (elite) modernity. Hu Jintao's "harmonious society" abandoned the rapid market reforms that had overstressed Chinese society and instead sought fairness, responsiveness and institutionalization. Xi Jinping warred against the Hu era's disintegrative forces that seemed to threaten social stability and Party control. Each of these was a major course change. This ability to articulate the key (perceived) problem and reshape theory and practice is a distinctive feature of post-Mao China as it was of South Korea and Taiwan—a sharp contrast with Japan's stodgy stability.

Structural change could come through self-correction in the context of continued leadership by Xi Jinping and possibly a successor chosen in an orderly process. In the extreme, elite discontents and mass disillusionment over declining growth and a failure of egalitarian promises could lead to a disorderly succession and attendant economic disruption.

This discussion highlights that the main economic risks are on the downside.

In broader perspective, China's drive for wealth and power and respect has been a centuries-long constant that has entailed rejection of many political and economic structures and many successive leaders. If the current structure turns out to mean that China will lag in incomes and technology for the indefinite future, that economic gains will be largely captured by a relatively narrow Party-government-business elite, that its dream of paramount global leadership will evaporate, that giving up freedoms no longer pays off in rapid growth, then domestic demands for change may become very powerful. As with the crisis of success, that does not inevitably mean that leaders will do what the West sees as the right thing, moving decisively toward more freedom and more market efficiency. It could also move decisively in a darker direction. Unfortunately the template of the East Asian model then goes blank.

The ultimate difference from the little dragons

When South Korea and Taiwan faced their crises of success, their historic choices paralleled that of China. Their economies were centrally controlled. The pinnacles were dominated in Taiwan by 40 Guomindang-owned infrastructure conglomerates and in Korea by a dozen chaebol that, although privately owned, received annual production quotas, export quotas, credit allocations, and interest rate determinations from Park Chung Hee's Economic Secretary. Taiwan's leader Jiang Jingguo was a committed Marxist-Leninist, educated in Moscow, a member of the Soviet Communist Party, and a ruthless security chief who sent dissidents to Green Island to be executed. Park Chung Hee's background was a combination of early Marxist-Leninist affiliations and Japanese-style military training. From those backgrounds they confronted a new era of social and economic complexity.

Jiang Jingguo, for all his ruthless Leninist history, proved to be exceptionally sensitive to the social changes in Taiwan society. Initially resistant to change, after the Kaohsiung riots of 1979 he relented gradually. Restrictions on the innumerable local Taiwanese firms gradually relaxed and eventually the local private firms towered over the obsolescent Guomindang conglomerates. Politically, first he allowed the democratic opposition to organize while keeping it illegal. He found it useful to have them organized so he could negotiate with them. Gradually he allowed elections. The trend continued until, under later Guomindang leader Lee Teng-hui, fully democratic elections occurred. Eventually the opposition won. In the interest of society, Jiang Jingguo had put party at risk, in both economic and political control.

Korea's system was more brittle. Unlike Jiang Jingguo, Park Chung Hee was isolated in Blue House. He did not understand the need for fundamental change and over time became more rigid rather than more flexible. But people around him understood that a new era had made the Park system obsolete. So one evening, the second most powerful man in South Korea, the intelligence chief, one of Park's closest friends, invited Park to dinner with two pretty girls and shot the President in the head. There followed a bumpy road through premature democratization, return to dictatorship, but gradual economic and political liberalization until Korea achieved complete democracy and a market economy (albeit an economy still dominated by a few gigantic firms, most notably Samsung).

Thus the fundamental choice of the smaller dragons was a priority for society over party. For a time China seemed to be making gradual, hesitant steps in the same direction. Social and intellectual life became remarkably free as long as one didn't challenge political stability. The gradual differentiation of Party from government from business, the gradual acceptance of rules like mandatory retirement of officials and a professional legal system, the gradual acceptance of key standards of business and government accountability and transparency, the emergence of local elections, and Hu Jintao's steps toward institutionalization and intra-Party democracy all could have become steps in the Jiang Jingguo direction. But the choice of Xi Jinping reflected a definitive choice by China's political leadership. The Party was at risk. That was intolerable. That must be prevented at any cost. As this analysis has documented, the cost has been and will be very high. China's leaders have chosen Party over society. That is the decisive difference from the smaller dragons.

A leadership that has chosen party over society will continue to experience the great paradox: While economic success have brought stability and confident internal security to other societies, including the smaller dragons, the U.S., Europe, Australia, New Zealand, and others, China's economic success brings enhanced domestic security fears and, cascading from those fears, security-related impositions on the economy that degrade future growth prospects.

Geopolitical implications

A slower-growing China will remain a huge market and a superpower, but it will not remain today's dominant driver of growth in developing economies and dominant magnet for developed countries' corporations. Presently China's trade and investment stimulus dwarf those of all others combined for China's neighbors and for Africa. After 2030, China will be one great economic power among several. The U.S. and EU will have similar magnetism and Japan will be large.

If the argument of this paper is correct, soon we will be in an era when China's maritime neighbors are growing twice as fast as China. Their relative ability to resist China's incursions will grow, their morale and unity might grow disproportionately, and China may struggle with imperial overreach.

If the U.S. keeps growing at recent rates, the curve of Chinese GDP might rise to bounce off America's and then be left behind. That outcome would depend on efficient U.S. economic management, at best an uncertain prospect. The reality of Sino-American economic competition is that we are currently in a historic race between Xi Jinping and Trump-Biden to see which country can degrade its economic management faster through protectionism, failure to deal effectively with great social changes, and dominance of politics over economics. Presently China is winning that downward race, but the race is tight and no outcome is inevitable.

While China's GDP may still become as large as America's in nominal terms, and is already larger in purchasing power parity terms, that may not imply overwhelming geopolitical clout. Its per capita income will still be a fraction of America's and, despite some impressive successes like its space program, its technological level may seriously lag. Harvard Professor Lawrence Summers vividly captured the comparison problem when he recently pointed out that, if the U.S. absorbed Mexico, its GDP would increase but its international clout would not necessarily increase. Inside China are many Mexicos. Likewise, University of California Professor Bradford Delong has characterized China as 60 million people living at Spanish levels, 300 million living at Polish levels and one billion living at Peruvian levels.

These are great historical tides. On the historical record, governing elites are very slow to recognize alterations in historical tides. Changed understandings and changed policies tend to occur only when the inertia of ingrained ideas and institutionalized doctrines hits a brick wall.[i25] In the U.S. the assumptions that China's rise is inexorable, that Xi's policies are forever, and that the Sino-America relationship is a

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[25]William H. Overholt and Marylin Chou, Foreign Policy Doctrines**, Policy Studies Journal,** Volume 3, Issue 2**,** December 1974, Pages 185-188

zero-sum game are already so ingrained in U.S. officialdom and some of U.S. academia, and they are so beneficial for national security budgets, that they are not likely to change soon in line with altered reality. The brick wall is not currently visible.

William H. Overholt is Senior Research Fellow at Harvard's Kennedy School. The author or co-author of nine books, he has held RAND's Distinguished Chair of Asia Pacific Policy and served as President of Fung Global Institute in addition to serving as chief Asia strategist of three investment banks.