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The fortunes of China are tied intimately with global economic growth. This year alone, 25 percent of export growth was a result of Chinese consumption. L21 has been doing some far ranging and in depth work with some leading think-tanks in London, Canberra and Sydney on the question of the future prospects for China.

In this edition of Worth Noting, we thought we would report some of our preliminary findings on the state of the 'Chinese economic miracle' and point out some extremely worrying signs ahead for the wannabe superpower.

Introduction

China's economic modernization program since the 1970s is seen as one of the most spectacular illustrations of economic transformation. More recently, their emergence as great economic power over the past decade since the reforms in the 1990s has given new impetus to the viewpoint that a 'China growing strong' will become the defining question for the foreseeable future. China's economic growth has been hovering at, or close to, the double digit mark for consecutive years since 1978 and most analysts from the World Bank to the OECD agree that China's economic boom shows little sign of slowing down.

Although this sustained run of economic growth is itself a phenomenon, what is enormously significant about it is the new consensus that is emerging with respect to how once economic backward states (especially those that organized themselves according to socialist principles) best make the successful transition from communist to free-market economies. For the Chinese leadership as well as many commentators, China's recent achievements provide strong evidence that a new exemplar for economic development has arisen. Although the Chinese leadership have never explicitly used this term, the 'Beijing consensus' rejects the previous primacy and logic of the 'Washington consensus' which argued that only 'big shocks' could deliver economic progress for once inefficient and corrupt systems. In particular, the 'Washington consensus' points to the success of economies such as Taiwan and South Korea and argues that rapid economic liberalization must be complemented by political liberalization that is tied closely to a democratization process.

In contrast, the 'Beijing consensus' presents a more 'flexible' viewpoint that developing economies must develop and reform at their own pace, and use their own methods rather than adopt a uniform, 'big shock,' liberal solution. In the words of former President Deng, China must 'feel for the stones when crossing the stream.' While the term might be a little misleading as there is no precise definition for what this 'Beijing consensus' means, there is broad agreement that the approach stands in contrast to approaches applied to post-Communist states like Russia which in the eyes of many used a 'shock therapy' that tried to reform too quickly.

The diplomatic coup of the 'Beijing Consensus'

While it is clear that China seeks to conduct reform in its own way, the real diplomatic coup that the Chinese leadership would feel pleased about has been the overwhelming acclaim for the Chinese approach.

The traditional argument in the West use to be that successfully developmental economics show a link between increasing economic success and increasing openness of the political system (e.g., Taiwan, South Korea.) From the beginning, China sought to reject this approach by following an economic liberalization, modernisation and reform process that was overseen by the existing centralized, one party state. In other words, China's leadership rejects the need for increased democratization whist undertaking reforms to encourage economic prosperity.

Moreover and significantly, this model not only severs the link between economic liberalization and democratization but positively argues that the maintenance of centralized power in the hands of the Chinese Communist Party (CCP) is actually essential to a successful economic reform process. Maintaining the internal political status quo, the CCP argues, is the only way sufficiently strong leadership can exist to drive these reforms forward.

There is no doubt that the ‘Beijing consensus’ is gaining global momentum. The general optimism shared about China’s continued rise is evident by the rush of high level delegations dispatched by major economies to Beijing to gain footholds in the seemingly insatiable Chinese market before competitors do so. At the political levels, China is fast becoming an exemplar for developing countries and governments. Former Soviet Republics such as Kazakhstan, Uzbekistan and Turkmenistan, to those in Latin America, to Iran, to Asian countries like Vietnam, to big powers such as Russia and India have all confessed to an admiration and fascination for the Chinese approach. Yet, although it is difficult to argue against evident success, China’s model rebuts Western developmental logic which has stood for several decades and there is surprisingly little skepticism of the Chinese approach. Part of the reason for public officials to keep any doubts they might have to themselves stems from China’s readiness to ‘punish’ or at least ‘admonish’ organizations or even countries who have in the past been critical of their authoritarian bent via thinly veiled threats to ‘complicate’ access to their market.

However, when it comes to politically disinterested commentary on the Chinese approach, although the challenges faced by China in the many areas are substantial and well documented, there is either little doubt expressed that these can be overcome, or more significantly, little attempt to put forward an approach that might be used to assess the extent to which these challenges can be overcome.

China’s reform success

The success of China’s reform and modernization drive since the 1990s is undeniable. In January this year, China’s GDP exceeded that of Britain’s and France’s, making China the fourth largest economy.

The challenge of the initial phase was to open the economy to trade, revive agricultural productivity which was lagging, and also to develop a more substantial manufacturing base. Another challenge was to either reform the hugely inefficient state owned enterprises (SOEs) or encourage the growth of a new dynamic private sector to promote competition and underpin the economic rise.

There is no need to go through in detail China’s reform initiatives here as acknowledging the success of these continued reforms is now orthodoxy. In the eyes of most commentators and governments, they seem to be making the right moves. Their economic fundamentals appear impressive, from their high savings rate (approaching 30% to 40% of disposable income) to their massive labour pool to a redoubtable work ethic and the development of a huge entrepreneurial middle class. Moreover China’s success has not just been driven by exports but also importantly by domestic-led growth, while their record of WTO implementation although initially shaky appears to be improving.

Although statistics emanating from official Chinese channels can be notoriously inaccurate, China can still boast two decades of continued and impressive growth and the world's most successful companies are all betting on China being their next big market. Financial institutions like Citibank, HSBC and Bank of America are investing billions on China's future by buying into China's state owned banks. Every global automobile brand is relying on China to underwrite their next stage of significant growth. Google and Microsoft are prepared to make substantial compromises to gain entry into the market. Chinese Internet businesses are reaching outrageous prices on the NASDAQ.

Are there reasons for pessimism?

The corporate world is enamored with the Chinese market while governments are looking to position themselves in a future world characterized by a Chinese great power. The orthodoxy is to work within a strategic framework that sees either threats or opportunities as 'China grows strong.'

The significant challenges that China must manage if they are to sustain their phenomenal rates of growth are increasingly well documented. Unlike the situation even just a decade ago, a lot more data is now available and commentators have used it to offer a clearer picture as to what is happening in especially the vast inner provinces. There is therefore no need to go too much into depth here as these challenges are well summarized elsewhere.

Briefly, these include massive unemployment and poverty in rural areas, serious health risks such as disease and HIV scenarios, vulnerabilities stemming from heavy dependence on outside energy sources, stretched water resources as well as growing pollution and environmental problems as a result of their rapid development, as well as a fragile financial system, highly inefficient SOEs, and any effect shocks in these areas would have on continued foreign direct investment (FDI) which is essential to China's continued modernisation.[1] In a recent treatment of the subject, a joint research report gave a more updated summary of the challenges and expands the focus to corruption, an aging demographic, rising instances of social unrest and the continued lack of political reform.[2]

Official Chinese news agencies are more than willing to release information showing that their leadership is serious about tackling these problems. Their very public anti-corruption drive is one example with a spate of high profile prosecutions and sackings beginning in 1995 with former Politiburo member Chen Xitong. In recent times, those that have been caught by this anti-corruption drive include the deputy Commander of China's navy Vice-Admiral Wang Shouye and Deputy

[1] See Charles Wolf, Jr., K.C. Yeh, Benjamin Zycher, Nicholas Eberstadt, Sung-Ho Lee, *Fault Lines in China's Economic Terrain*, RAND, Santa Monica, 2003.

[2] See www.chinabalancesheet.org, C. Fred Bergsten, Bates Gill, Nicholas R. Lardy & Derek Mitchell, China: The Balance Sheet , Centre for Strategic & International Studies and Institute for International Economics, 2006.

Mayor of Beijing Liu Zhihua who was overseeing the city's makeover for the Olympics. The execution of officials for corruption is cited by the leadership as evidence of President Hu's and Premier Wen Jiabao's self-declared determination to tackle what President Hu has called "rampant" corruption within party and public circles. Another example is facing the problem of severe environmental degradation as a result of blinkered development. According to The Worldwatch Institute, sixteen of the world's twenty most polluted cities are in China. President Hu's series of very open admissions that China's existing ways of development were "environmentally unsustainable" took many internal party apparatchiks, used to a rapid development emphasis, by surprise.

To those who have bet heavily on China's rise, these examples indicate a leadership willing to face up to the major challenges that would jeopardize continued economic growth. To cynics, using progressive terms like 'sustainability' or prosecuting a handful of high profile officials that have fallen out with party leadership is little evidence of real progress.

Assessing success or failure

Beyond updated 'progress reports', few are willing to offer bold assessments, much less predictions of the success or otherwise of the Chinese leadership confronting these challenges.

The key is to locate an approach that makes assessment much more feasible. The weakness of many commentaries about China is that although the challenges faced are increasingly well documented, there is a general failure to draw links between these challenges and the prospects of success or failure in overcoming them. Hence, merely documenting reform initiatives give us little clues with which we can make any strong forward looking assessments. Since China has experienced double digit growth for a decade leading into the 1990s and high single digit growth over the past decade, the verdict that China is generally succeeding in meeting their challenges and will succeed is frequently presupposed. If their growth has been so impressive, many argue that it is clear that their reform process must be proceeding well. If not, one has to account for why their growth trajectory has been so successful if there are indeed serious flaws in the Chinese reform process.

The story so far …

The general consensus is that China's economic miracle has been the result of a combination of ideological, structural and labour force changes. The main ideological and structural change is the embracing of free market principles, particularly in the opening of the economy to trade and foreign direct investment (FDI), as well as more market based processes of allocating goods and capital. The latter, although only a minor percentage of overall investment, is particularly important in terms of transforming internal processes and skills, and importing technology, to compete. Prior to recent reforms, it was the responsibility of China's State Planning Commission to allocate industrial commodities such as steel and machinery and these same bureaucrats 'rationed' consumer goods as well as set prices of commodities in arbitrary and ad hoc fashion. The result was little connection between price, demand and productivity – an essential feature of any efficient free market. Similarly, the allocation of capital was once largely determined by 'policy' rather than productivity or profitability. Even though capital allocation liberalization has proceeded slower than expected, there is now some future correlation planned between expansion and profitability. More profitable firms are in principle able to use retained profits to expand while less profitable or loss making ones will grow more slowly or eventually close down.

Moreover, China's savings culture has been a massive boon. The extraordinary high levels of savings at about 30% have really supplied the capital needed for growth. Although FDI is significant in terms of importing technology, processes and know-how, FDI has only financed about 5% of China's capital outlays in recent years. Indeed, China is actually a net supplier of capital to the world.

Labour force changes include reforms to encourage the greater mobility of labour. This has occurred in two main ways. First, in the past, the state assigned jobs to individuals and wages were set by the state. Subsequently, there was little opportunity or tolerance for labour movement. Second, restrictions of the migration of labour from rural to urban regions also meant that millions were artificially kept in inefficient farming sectors. Following loosening of these conditions, mass migration to urban regions occurred. This had a complementary effect. Millions left inefficient farming sectors to bolster the numbers of the manufacturing sector in particular. From 70% of the workforce working in the highly inefficient rural sector a couple of decades ago, it is now about 50%. As greater numbers of workers entered the more efficient manufacturing and services sectors, productivity levels significantly improved.

Is China really a 'free market' economy?

So far so good but is the hype surrounding the 'Beijing consensus' just that – hype – or are we watching a new model of developmental economics unfold? Real output per capita might be almost ten times what it was thirty years ago when the reform process began but in global per capita terms, China is still a poor country . Their GDP per capita is still only about US$1,800 and reforms in all areas still have a long way to go. Moreover, dramatically improving GDP figures tells us only a small part of the story. Despite rosy predictions about the Chinese economy surpassing the United States as the biggest in the world by about 2035, the splendor of the Chinese model which so far has captivated so many must now be subject to some tough questioning.

Almost all commentators agree that for China to maintain a consistent level of modest economic growth over the next decade, let alone continue their phenomenal growth trajectory, they must address several areas of profound concern.

The first is continuing reform of their hugely inefficient SOEs. Despite the common portrayal of China as a 'free market' economy, official Chinese figures show that state bodies accounted for almost 40% of China's GDP and employed about 85 million people. State owned production in another developing giant like India, to put it in perspective, accounts for only about 7% of GDP. Moreover, bear in mind that to place further perspective on the figure, the private sector in China employs only about 65 million people. Furthermore, when we look further into their economic structure, we see only glimpses of a 'free market' economy. Recently released figure for 2003 showed that the state controlled $1.2 trillion worth of capital which amounts to about 56% of the country's fixed assets. Therefore, even though China has actually reduced the number of SOEs from about 300,000 a decade ago to 150,000, many foreign investment banks operating in China estimate that the private sector still only accounts for about 35% of the economy. It is also a very 'Chinese' version of a free market in which the state remains a monopolist or dominant player in key sectors such as financial services, energy, telecommunications, steel, natural resources and transportation, and protects itself from competition by blocking domestic private firms and foreign entities from those markets.[3] At most, competition is allowed within SOEs themselves. For those who maintain that China is a 'free market' with a thriving private sector, bear in mind that there are only about 40 private firms amongst over 1,500 Chinese companies listed on domestic and international exchanges.

Second, China's financial system by any measure is in severe trouble, if not imminent collapse. About 98% of banking activity is conducted by state controlled entities. Their banking system (made up overwhelmingly of these state controlled entities) is most probably the weakest in Asia, overweighed with non-performing loans, and costs China an estimated 30% to 40% of annual GDP in bailouts just to prevent the sector from collapse.

Third, even though it was stated earlier that there is an 'intended' correlation between capital allocation and profitability, China's largely remains a command economy and reforms to allocate capital efficiently have been unsatisfactory. World Bank estimates show that about a third of state investment decisions between 1991 and 2000 were not commercially motivated ones. Even China's Central Bank's own research reveals that politically directed lending is responsible for about 50% to 60% of bad loans. Even though optimists frequently speak about the virtue of a 'consumption led' growth strategy, Chinese economic planners admitted in 2006 that eleven major capital-intensive industries were chronically over-producing. Most glaring was the steel industry which produced about 30% excess above demand.

[3] I am indebt to Pei for his research bringing out these figures. For discussion of these figures, see Minxin Pei, *China's Trapped Transition*, Harvard University Press, London, 2006.

A work in progress or fatally flawed?

It might be open for optimists to argue that China is going through a period of profound transition and these are the growing pains expected of any changing economy. Besides, the 'Beijing consensus' does not say China has found an easy path towards modernization, only that the Chinese model of autocratic leadership is working better than other models of development. China, under this viewpoint, is best seen as an enormously promising 'work in progress.'

At this point we should turn our attention to the Chinese 'political model' of economic modernization. The 'opening' of the Chinese economy and other reforms were instituted not only to accelerate wealth creation but also to maintain the CCP's hold on power. Like many developing systems dominated by one party such as in Malaysia, Singapore, and Japan, and even more so in China where other political parties are banned, continued political dominance always relied on (perception of) successful economic progress and confidence in the ruling party's ability to set a course for increased prosperity. Even though the CCP concedes that there is a need for political reform, such reform is not a move towards democratization as the West might understand the term. Political reform measures are internal processes within the CCP aimed at keeping Party members happy, the Party in control, and maintaining its dominance. Hence, any talk about 'democracy' concerns only 'inner-Party' democracy and reform of the party's internal appointment and accountability procedures. For reasons that will be outlined shortly, the one-party model is really the crux of the matter in assessing the longer term prospects for the broader Chinese development model.

To simplify the question, what are the prospects of China's 'command economy' dealing successfully and adequately with the problems of poorly performing SOEs, financial sector weaknesses and inefficiencies in capital allocation? When one looks closer at these challenges, a significant cause of the problems is intrinsically political. As I argue, since there is little chance of the CCP renouncing power or being removed from power anytime soon, it is surprising that there is not more pessimists among us.

As both political scientists and observers will agree, authoritarian regimes can never maintain power through coercion alone. Their authority must be 'legitimate' or consented to by the entrenched or emerging elites. Hence, coercion is mixed with support of key groups which in China's context are the bureaucracies, the military, and more recently the emerging business and entrepreneurial classes. As one commentator has observed, "an authoritarian regime imperils its capacity for political control if it embraces full economic liberalization. Most authoritarian regimes know that much, and none better than Beijing."[4] Let's see how this impacts on China's ability to confront key challenges.

[4] Minxin Pei, "The Dark Side of China's Rise", *Foreign Policy*, March/April, 2006.

Consider the issue of reforming the hugely inefficient SOEs. The figures trotted out for reform in this area are impressive. The raw number of SOEs have halved from a decade ago to 150,000. Where in 1978 SOE's employed about 19% of the working population, they now employ only about 9%.

Yet, looking at less quoted aspects of SOEs can tell us another story. SOE's might employ only 9% of the working population now but this still amounts to almost 70 million workers, just slightly down from 75 million workers in 1978. Some might argue that this is fair enough given that it is not feasible to simply disband SOEs due to the massive unemployment that would result. Fair enough but what about reform of SOEs to change them from chronically underperforming entities to competitive businesses?

Competition, effective corporate leadership, and transparent processes would seem to be essential to any reform process. Instead, the major industries (with rare exceptions) that SOEs still largely operate within remain shielded from outside competition. Private and foreign firms are allowed to enter into the 'open' Chinese market mainly where SOEs do not operate or where the production levels of SOEs are so poor that there is a need for an alternative in that sector. Moreover, where once favoured Party officials and supporters were appointed to military or bureaucratic posts, they are now appointed to SOEs and other state backed corporations. Out of every five chief executives of an SOE, the CCP appoints four of them. Well over half of the senior executives are appointed by the Party. While many applaud recent decisions by the Chinese to allow minority foreign ownership of SOEs, and blue chip investors like Bank of America have responded, allowing minority private shareholding and even listing on foreign stock exchanges merely give these SOEs the appearance of operating like a normal 'for profit' corporation. In the 'minority privatization' of these SOEs, the Chairman of their Boards remains CCP secretaries half of the time. Significantly, in the latest available figures which are for 2003, of the 5.3 million Party officials, almost 10% of them, and 16% of the urban members, held executive positions in SOEs.

When seen from this perspective, the expected link between financial performance and promotion that underpins any viable corporation is far from healthy in these SOEs. While there is much focus on genuinely successful private entrepreneurs who have built credible companies, rewarding Party officials with executive positions in SOEs operating in heavily protected industries is the new form of privilege that the CCP affords to loyal senior members. The relationship between economic reward and party loyalty rivals and probably exceeds what occurred in failed regimes such as the Suharto regime in Indonesia which operating what economic historians commonly depict as a system of 'crony capitalism.' Hence, while commentators might applaud President Hu's recent campaign against 'rampant' corruption, there appears something questionable about the sincerity of such campaigns when the most virulent and costly forms of such 'rampant' corruption are relied upon by the one-party regime to maintain their system of patronage and reward which is essential to remain in power. Even in China's satirized ‘guilty until proven innocent’ system, of about 171,000 party officials and members implicated in corruption activities, less than 3% were subsequently prosecuted. The rhetoric of naming ‘corruption’ as a challenge China must overcome rings hollow when view in this light. The problem is that the existing political system of the one ruling party positively relies on forms of corruption rampant in their economic system to maintain their authority. ‘Free market’ activity such as ‘privatisation’ simply affords greater opportunities for politically connected insiders to benefit. For example, it is estimated that about 30% percent of all owners of privatized SOEs are CCP party members. Seen in this light the reluctance to open up SOEs, especially those operating in the most important sectors, to genuine competition and international standards of transparency is not politically viable for the leadership.

It is also not surprising that since protecting SOEs are so important to the legitimacy of the CCP, supporting businesses that serve a political agenda is hardly a conducive formula for the efficient allocation of capital by the state, and by state owned and run banks. Chinese central bank research showing that politically directed lending is rife, with 60% of bad bank loans a direct result of this political lending. This is not merely an economic challenge but a problem created and sustained by the political setup. State banks, which comprise about 98% of banking activity, have the dual function of first supporting government policies, and second as financial intermediaries in a market economy – in that order of priority. The 1994 *Commercial Bank Law* states that after a transition period of ‘unspecified duration’, all banks are to operate as independent entities. Meanwhile, they must lend according to economic, social and political needs as specified by the State Council.

As to be expected, capital allocation determined by political imperatives rather than to support open and competitive businesses according to normal free market principles means a systemic predilection towards capital misallocation. Hence, the leadership sees no choice but to support SOEs that boast a median rate of return on assets of between 1% to 2%. Common estimations are that SOEs contributed to one third of China’s GDP while consuming two thirds of investment capital. Moreover, although official Chinese figures unrealistically placed non-performing loans at about 9% of GDP, this figure is misleading as banks frequently ‘roll over’ bad loans such that they do not appear on the accounts as non-performing loans. International and foreign analysts put the figure much higher at closer to 50% or 60% of GDP. An observation which has been made by increasing numbers of commentators is that China is the only country in history to have achieved both record economic growth and record numbers of nonperforming bank loans simultaneously.[5]

Moreover, the so-called ‘middle class’ that is emerging is not the middle class that Western societies might associate with the term. The ‘middle class’ in China is

[5] See op cit., Pei (*China’s Trapped Transition*), and Gordon G. Chang, *The Coming Collapse of China*, Arrow Books, London, 2002.

more a broad group comprising the ‘privileged class’ that the leadership increasingly relies upon for support and legitimacy. In turn, this ‘middle class’ is supported through financial perks, privileged contracts, state awards, and access to local and senior political figures. For example, almost 10% of senior professionals receive ‘government stipends’ and tens of thousands of senior academics have been recruited into senior party and governmental positions. Subsequently, not only is criticism from China’s intelligentsia rare; the intelligentsia is actively targeted by the Chinese leadership to gain their support.

This political and economic setup offers an illuminating context and connection between reported ‘challenges’ such as the increased instances and size of social unrest incidents (from 8,700 in 1993 to 87,000 in 2005) and the significantly self-serving reforms overseen by the leadership. Modern China has moved on from Mao’s China which co-opted the peasant classes towards a Chinese leadership which garners support from the economic and intellectual elites along with existing bureaucratic and political classes. Instances of unrest overwhelmingly involve the perceived corrupt, arbitrary, or unfair practices of government officials. As evidence of the move away from Mao’s peasant China, estimates are that about three quarters of rural Party organizations are experiencing a serious legitimacy problem vis-à-vis local populations and are in a state of collapse. Although few predict the imminent collapse of the CCP, anything short of a continued stellar economic rise will seriously threaten the legitimacy and credibility of the CCP during this transformation of the Party’s support base.

Where to now for the Chinese model?

When thinking about modern China, many see only the postcard picture of Shanghai or Beijing – Beijing’s new National Theatre (which will cost about US$450 million), shopping malls, imposing glass buildings, and growing numbers of talented expatriates seeking their fortune - as representative of what China is becoming. With reputedly more cranes and construction sites in the one city than in all of the rest of Asia, Shanghai in particular is a seductive symbol for optimists who believe that an economic miracle is unfolding before us.

The question we have been asking is whether the ‘Beijing consensus’ is blind to inherent flaws in China’s autocratic model of development? The CCP issued a white paper at the end of 2005 emphasising its plan to build “a socialist democracy with Chinese characteristics.” These ‘characteristics’ entail a single minded determination to preserve the one party state. Behind this perceived economic miracle, the question we should be asking is whether the uncompromising political priorities of the leadership to stay in power by co-opting a new privileged class will seriously or even fatally stifle the longer term economic development of the country?

We believe that proponents of the ‘Beijing consensus’ fail to realize the significance of the relationship between the political and economic model. Just as the one party solution of the ‘Beijing consensus’ puts forward strong, singular leadership as a developmental advantage, we should also inquire as to the economic costs of a political system of privilege and patronage needed to legitimize and garner support for the sole ruling party. The Chinese ‘gradual’ approach was adopted largely due to the leadership’s fears of losing power in the event of rapid reform and resulting social upheaval and loss of legitimacy and relevance of the CCP. There is every reason to believe that preserving power remains a greater priority over necessary economic reform should the two priorities be in conflict. Hence, rather than viewing autocracy as developmental virtue, the Chinese leadership might be overseeing what some have called a ‘predatory state’.[6]

It is also important to note that the actual size of the Chinese state during the reform period is growing, not shrinking. Officials and employees in state agencies was growing at about 2% prior to 1978 but grew at almost 7% between 1979 and 1990. No figures have been released after this period but almost all anecdotal evidence agrees that growth rates of the bureaucracy have at least kept pace to the present day. What this tells us is that the ‘predatory state’ is inefficiently absorbing more, not less, capital and resources as the ‘China model’ evolves.

What about the successes so far? What accounts for that? Although impressive, China’s growth has been underwritten by a high domestic savings rate which has led to massive increases in investment as well as a shift from agriculture to manufacturing. However, growth which has occurred largely as a result of massive availability and injections of investment funds cannot be sustained if the economic and investment regime remains inefficient. For example, injecting massive funds into supporting or setting up inefficient industries and sectors will still count as growth but longer term economic benefits will not occur. Inefficient government spending will always occur in especially developing economies but China’s current growth trajectory is dependent on public spending which is inefficient by virtue of the policy directed spending. ‘Perspiration’ and the admirable work ethic of Chinese workers cannot alone offer sustained development. The growing costs of ‘blinkered’ growth policies such as extreme income inequality and severe environmental degradation does not augur well for social order and social capital needed for sustained development. In other words, ‘growth’ alone is a blunt instrument with which to probe a country’s economic prospects.

Conclusion

We believe that the significant variable in assessing China’s development is a political one since it is the ruling regime that threatens future economic development. The autocratic regime and approach is part of the problem, something ignored or denied by the ‘Beijing consensus.’ So much excitement has been generated by the rise of China that inadequate attention is being paid to serious flaws in their development model. The usual caution in heralding the rise of

[6] For example, see Minxin Pei, *China’s Trapped Transition*, Harvard University Press, London, 2006.

a great power and the model adopted by that power has been misplaced in many parts.

In terms of future prospects, there is little organized opposition to the CCP. Instances of unrest, although increasing dramatically, are not organized or politically inspired but are usually spontaneous eruptions of anger by the losers of the country's transition. New business and educated elites have been skillfully co-opted by the leadership while important groups such as the bureaucracy remain entrenched.

The possibility of regime change is highly unlikely unless there is genuine regime collapse. Authoritarian regimes like the CCP remain reliant on offering benefits and opportunities to the groups that support them. In the event of China becoming a big but stumbling and even debilitated economic power unable to find the political will and capacity to solve their serious economic problems, the conditions will then become much more conducive for regime collapse. As the economy falters and capital (both domestic and foreign) is in increasingly short supply, the leadership will have less capacity to use public funds to help entrench their power.

Most analyses of China look at the strategic possibilities and challenges as China grows strong. Beyond the 'rise of superpower' scenario put forward by so many under the broad cover of the 'Beijing consensus', this is an alternative picture that should be more seriously considered in current scenario and strategic planning.