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China's Biggest Problems Are Political, Not Economic

Although China has successfully confronted its recent short-term economic problems, large challenges remain. Some are economic. But the bigger challenges are political, both internally and with the rest of the world.

China's critics predicted an economic hard landing when its growth began to slow, pulled down by shrinking export markets and the excess industrial and residential investment the country had generated in response to the global downturn at the end of the previous decade. Overcoming this slowdown was made more difficult by China's need to reverse a rise in domestic inflation, particularly the surge in real estate prices.

While doubts can remain, it looks like all three problems are under control. GDP growth will probably be at an annual rate of 8% this quarter and heading higher. The central bank has eased monetary policy, and the government has instructed commercial banks to increase lending. Although some of the new stimulus will add to excessive industrial capacity, much of it will go into needed urban infrastructure and low-income housing.

Inflation has come down to less than 3%, now that world prices of food and energy are no longer accelerating. Real-estate prices remain very high but have stopped rising, thanks to a variety of government limits on speculative investing.

Yet longer-term economic issues remain. The population is aging rapidly as a result of China's one-child policy, creating a problem for financing the benefits and health care of future retirees.

The new Five Year Plan calls for increased urbanization and a shift in the economy's balance from industry to services. If it succeeds, it will create millions of urban jobs for current low-income rural workers, raising the share of national income that goes to wages and consumption. That emphasis on services would also reduce the reliance on heavy industry that now creates pollution and water shortages. Greater consumption would also reduce China's dependence on export industries to provide employment. So a lot rides on the success of these initiatives.

The political problems are even more difficult. Corruption, income inequality and party governance are at the top of the list of domestic issues.

The Chinese leadership acknowledges that corruption is widespread, involving not only low-level bureaucrats but also senior officials. The corruption problem interacts with the public's concern about income distribution. While some of the very large Chinese fortunes are the fruits of successful entrepreneurial efforts, the wealth of senior officials and their children is widely regarded as the result of corruption and bribery. Thousands of rural riots each year reflect the seizure of land by local officials who sell it to real-estate developers at bargain prices. The Chinese people know that when Deng Xiaoping famously said "To get rich is glorious," he didn't mean that to apply to corruption.

Beijing's collective leadership—through the State Council and the Communist Party's Politburo—appears to be in trouble. The recent experience with Bo Xilai, a Politburo member and party chief in Chongqing, was a dramatic illustration of the conflict within the leadership and the extent of palace intrigue.

Mr. Bo was trying to promote himself for a place in the top leadership with mass rallies singing the songs of the Mao era, and by advocating a return to Maoist policies of a heavier economic role for the state. Although he had some high-level supporters at the time, he has now been stripped of all official positions, and his wife is accused of murdering a British business associate.

Without elections, the leadership has a hard time judging the extent of public support. After abandoning efforts to close Internet cafes a decade ago, senior political leaders now say they read Internet blogs to sense the mood of the people. They worry about the discontent of the population and fear any demonstrations that could develop into another Tiananmen episode.

The potential for dangerous unrest is increased by the large discrepancy between male and female birth rates (13% more male babies are born than female babies), leading to tens of millions of young men who have no prospect of finding a bride.

These domestic problems are now matched by troubles abroad. Until recently, China kept a low international profile and focused on its domestic growth. Now it has become much more assertive internationally, making strong claims to territories and mineral rights in the South China Sea as well as to traditionally Japanese islands.

These claims have put Beijing in conflict with other East Asian nations, especially with Vietnam, the Philippines, South Korea and Japan. China's navy has played a prominent role in these conflicts. Such aggressive policies have turned East Asian nations away from China to seek stronger alliances with the United States.

Beijing is widely accused of using cyberspace to steal other governments' secrets, industrial technology, and the negotiating plans of governments and industrial firms. Foreign business leaders also complain of the loss of their proprietary technology due to China's policy of mandatory technology sharing by businesses that operate in China.

These sources of conflict are potentially much more important than disagreements about China's currency policy. The new Chinese leaders who will begin their 10-year terms this fall have much to do at home and abroad if they want their country to continue its successful and peaceful rise in the global economy.

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