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China, as a result of its unprecedented economic performance and significant increase in comprehensive national power, has reemerged as an influential polity in the international arena. However, significant domestic issues centered around its looming debt crisis and changing demographic landscape threaten its continued rise and the legitimacy of the Chinese Communist Party as the governing body of China. Should the CCP continue to ignore these significant domestic issues, the gap between the expectations of its over one billion citizens and performance of the Party may reach a critical point. Until it shores up its domestic issues, the rise of China will be anything but inevitable.

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## Executive Summary

**Title:** Debt and Demography: The Achilles Heel to Chia's Inevitable Rise

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**Thesis:** Although China—as a result of its unprecedented economic performance and significant increase in comprehensive national power—has arrived as an influential polity in the international arena. However, numerous domestic issues centered around its debt and demography threaten its continued upward movement and make the rise of China anything but inevitable.

**Discussion:** A great deal of academic rigor, policy formulation, and defense planning have been focused on the rise of China. Some analysts and policy makers argue China's rise and eventual replacement of the United States as the world's leader is inevitable. Analysts and policy makers are also split as to China's intentions; whether China wishes to dissect the international organization construct or operate within it, adjusting organizations and policies to better benefit itself. Regardless, China is facing several domestic issues centered around its debt and changing demographic landscape that threaten the Chinese Communist Party's goal of a "harmonious society." Further, China's domestic issues also pose a problem for its leadership as the gap between the expectations of its over one billion citizens and performance of the Party widens. If China wishes to continue its upward and gain increasing power to influence global affairs, it must address these issues. Until it shores up its domestic issues, the rise of China will be anything but inevitable.

**Conclusion:** China's looming debt crisis and negative demographic shifts threaten to erode China from within. With rising expectations from its over one billion citizens, the Chinese Communist Party must address these issues if China wishes to have a solid foundation from which to project its national power.

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## **Introduction**

As the result of its unprecedented economic performance which cemented it as the world's second largest economy and its significant increase in comprehensive national power, China has become an influential polity in the global arena. In response analysts, policy makers, and government officials have become focused on the rise of China and its possible intentions with respect to the current international system. Some argue the rise of China is inevitable. Further, analysts, policy makers, and government officials are split when it comes to the intentions of a rising China. Some argue China wishes to dissolve the current international system. Others argue China does not want to dissolve the current international system, but rather adjust it to be more in line with its interests. Regardless of its intentions, China faces several domestic issues that if not addressed threaten to bring its rise to a halt. China's looming debt crisis poses a real threat to its continued economic growth. Its transitioning demographic landscape poses several threats itself as China's population is getting older, meaning its workforce is decreasing and becoming unable to support its expanding retirement aged population. China's One-Child policy has resulted in a severe gender imbalance and resultant marriage squeeze which has created an entirely new social class. In search of better paying jobs, droves of citizens are moving to China's megacities, causing an urbanization problem China is ill prepared for. Social uprisings pose a direct threat to the Chinese Communist Party's desire for a "harmonious society." Resource scarcity and environmental degradation not only pose a threat to its citizens, but also limit economic growth. As the domestic health of a nation dictates its ability to project power globally, China's rise is anything but inevitable.

## Background and Context

China has come a long way since its official inception as the People's Republic of China in 1949 to its position as a global influencer today. To provide context for its resurgence as a global power, a brief background is important.

Following Mao Zedong's ideologically steeped leadership and implementation of his Great Leap Forward and Cultural Revolution, China was left in shambles.<sup>1</sup> Filling the small gap between two of China's most influential leaders, Mao Zedong and Deng Xiaoping, Hua Guofeng recognized China's need for reform, however, his intense loyalty to Maoism—along with a significant portion of the population—prevented any significant change.<sup>2</sup> His successor, Deng Xiaoping, changed the strategic outlook of China. His “Four Modernizations”—Agriculture, Industry, Science and Technology, and National Defense—designed to modernize China by the end of the century were the enabling feature of China's rise.<sup>3</sup> China's next two leaders, Hu Yaobang and Zhao Ziyang—backed by power entities within the Chinese Communist Party (CCP)—continued to shift away from Maoism in favor of a more pragmatic and liberalized China. While their economic, cultural, rural, and foreign policy reforms were largely supported, their liberalized political reforms met significant resistance with powerful elites within the CCP. During Zhao Ziyang's leadership, China was largely viewed by the West to be the most open it had ever been in the history of the People's Republic of China.<sup>4</sup> Unfortunately, Zhao Ziyang's

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<sup>1</sup> Frank Dikotter, “Mao's Great Leap to Famine,” *New York Times* (December 15, 2010) <https://www.nytimes.com/2010/12/16/opinion/16iht-eddikotter16.html>; Tom Phillips, “The Cultural Revolution: All You Need to Know About China's Political Convulsion,” *The Guardian* (May 10, 2016) <https://www.theguardian.com/world/2016/may/11/the-cultural-revolution-50-years-on-all-you-need-to-know-about-chinas-political-convulsion>.

<sup>2</sup> David Mason, “China's Four Modernizations,” *Asian Affairs: An American Review* 11, No. 3 (1984): 47-70 <https://www.tandfonline.com/doi/abs/10.1080/00927678.1984.10553699>.

<sup>3</sup> Immanuel C. Y. Hsu, *China Without Mao: The Search for a New Order* (New York, NY: Oxford University Press, 1990), 92.

<sup>4</sup> Julian Gewirtz, David Shambough and Tom Brokaw, “An Alternative History for China,” *Foreign Policy* (August 19, 2016) <https://foreignpolicy.com/2016/08/19/an-alternative-history-for-china-under-liberal-zhao-ziyang>.

leadership ended on one of China's most regrettable incidents: Tiananmen Square. Tiananmen Square—the collision between rising expectations built from positive reforms and a nascent market economy and the factions within the CCP fighting to determine how China would be led—was the incident that vectored China down the path to where it is today. Replacing Zhao Ziyang, Jiang Zemin revectorred China with both increased Party control over its people and greater economic reforms. Hu Jintao and Xi Jinping have continued to focus on China's economy while slowly instituting policies allowing the strange mix of Chinese Socialism and open market economy to work.

As a result, China has been one of the world's fastest growing economies. The World Bank described China's economic growth rates as “the fastest sustained expansion by a major economy in history.”<sup>5</sup> China is making its arrival on the global arena known by continuing to expand its economic influence throughout the world. Although China—as a result of its unprecedented economic performance and significant increase in comprehensive national power—has arrived as an influential polity in the international arena, domestic issues centered around its debt and demography threaten its continued upward movement and make the rise of China anything but inevitable.

This paper will first address the domestic issues threatening China's rise. It will then demonstrate that although the CCP has demonstrated its ability to adapt, its policies are mostly symptom-based and may not bring about the changes necessary to resolve its significant debt and demographic domestic issues. Finally, recommended reactions the United States should pursue with respect to the three courses of action the CCP could take regarding the future of China will be presented followed by the conclusion.

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<sup>5</sup> Wayne M. Morrison, “China's Economic Rise: History, Trends, Challenges, and Implications for the United States,” Congressional Research Service (February 5, 2018) <https://fas.org/sgp/crs/row/RL33534.pdf>.

## **China's Debt Crisis**

One of the most significant issues hindering the rise of China is the expanding debt crisis plaguing all levels of the country. In response to the Global Financial Crisis (GFC) of 2008, China—largely funded through loans from its state banks—injected a \$600 billion stimulus package into its economy, mostly in the form of infrastructure projects.<sup>6</sup> That stimulus package equaled 13 percent of China's Gross Domestic Product (GDP) in 2008 and dwarfed the corresponding stimulus packages of the United States and Japan which were \$152 billion and \$100 billion respectively.<sup>7</sup> Since then, China's debt has only continued to grow—and at a particularly alarming rate in the past decade—to the current looming debt crisis observable today. To provide more granularity, it is important to break down China's debt into the sectors used to describe a state's debt: household, corporate, and government.<sup>8</sup>

## **Corporate Debt**

The sector of Chinese debt most dangerous to China is its corporate debt—comprised primarily of loans and bonds corporations use to finance operations—is a measure of the health of a nation's economic machine. In 2017, the China Power Project team reported China's corporate debt to measure 160.3 percent of its GDP.<sup>9</sup> For perspective, in 2017 the corporate debt of Japan and the United States measured 99.9 percent and 73.6 percent of GDP respectively.<sup>10</sup> More notable however is China's corporate debt to GDP percentage compared to its emerging market peers. Malaysia's corporate debt to GPD measured 67.3 percent and Brazil's corporate

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<sup>6</sup> China Power Team, "Does China Face a Looming Debt Crisis?" China Power (September 7, 2017) updated February 28, 2019, accessed March 22, 2019: 2; <https://chinapower.csis.org/china-face-looming-debt-crisis>.

<sup>7</sup> China Power Team, China Power, 2.

<sup>8</sup> Steven G. Cochrane, Katrina Ell, and Marc Korobkin, "Some Rising Pressure Points in Global Debt," Moody's Analytics (January 2019) <https://www.moodyanalytics.com/-/media/article/2018/global-debt.pdf>.

<sup>9</sup> China Power Team, China Power, 3.

<sup>10</sup> China Power Team, China Power, 3.

debt to GDP measured 43.9 percent.<sup>11</sup> While China's corporate debt has continually risen since the GFC, the greatest cause for concern is its rapid increase in such a short amount of time.

Between 2009 and 2017, China's corporate debt increased 60 percent (as a ratio of GDP).<sup>12</sup>

The cause of China's dangerous corporate debt level can be traced back to the stimulus package used to mitigate the GFC. Using massive infrastructure projects to stimulate the economy, Chinese banks issued incredible amounts of loans to build high-speed railways, bridges, and roads. Because return on investment from infrastructure is extremely slow, most firms could not meet their financial obligations to the banks that financed their operations. Rather than let these companies default, the CCP directed the banks to either forgive or extend the loans indefinitely. While China may have been able to rectify the situation with the termination of the policy, Chinese firms have been increasingly using credit to fund operations since 2008.<sup>13</sup> Exacerbating the problem, Chinese firms have not only been reliant on loans to fund operations, but they have also been operating extremely inefficiently. Referencing a 2018 survey of 2,000 Chinese companies conducted by the Cheung Kong Graduate School of Business, the China Power Project team found that "one third of China's industries suffered from overcapacity and 11 percent of factories produced (on average) 20 percent more goods than the market demanded."<sup>14</sup> Alarming, China's Incremental Capital Output Ratio (ICOR)—a measurement of how much capital investment is required to produce an additional unit of output—has more than tripled from 2009 to 2017.<sup>15</sup> This is extremely dangerous for China as it displays an alarming number of corporations within China are upside down with respect to their

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<sup>11</sup> China Power Team, China Power, 3.

<sup>12</sup> China Power Team, China Power, 3.

<sup>13</sup> China Power Team, China Power, 4.

<sup>14</sup> China Power Team, China Power, 4.

<sup>15</sup> China Power Team, China Power, 5.

corporate debt. The debt taken on by these firms has not resulted in the desired equal or greater than level of output required to pay off their debt. Chinese State-Owned Enterprises (SOE) are the largest contributing factor to this phenomenon. As of 2016, SOEs were responsible for over half of China's corporate debt, but only contributed to 22 percent of GDP.<sup>16</sup>

Also driving Chinese corporate debt levels is China's notorious shadow, "off-the-books" banking system. Nonstate local banks have been issuing loans to corporations while operating outside of government oversight. Because they operate outside of government oversight, they can issue higher risk loans to corporations who would have otherwise been denied. The China Power Project team reported the International Monetary Fund (IMF) estimate that "15.5 percent of all commercial bank loans to China's corporate sector can be deemed "at risk," where a firm's earning cannot sufficiently cover the interest expenses of its loans."<sup>17</sup> Not surprisingly, China's shadow banking conglomerate grew from \$80 billion in 2006 to \$9 trillion in 2018.<sup>18</sup> More frightening is the data released from S&P Global rating which claims China may have anywhere between \$4.5 trillion and \$6.0 trillion in hidden local government debt.<sup>19</sup> A report put out by the World Economic Forum listed China's fastest growing economic sectors as healthcare, technology, education, and entertainment—sectors completely different than where most of its SOEs are found.<sup>20</sup> This only adds to the complications these SOEs will have repaying their problematic loans. China's enormous corporate debt and the precarious system it operates in are

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<sup>16</sup> China Power Team, China Power, 6.

<sup>17</sup> China Power Team, China Power, 7.

<sup>18</sup> China Power Team, China Power, 7.

<sup>19</sup> Gloria Lu, et al., "China's Hidden Subnational Debt Suggests More LGFV Defaults are Likely," S&P Global Ratings (October 15, 2018)

<https://www.spratings.com/documents/20184/0/ChinasHiddenSubnationalDebtSuggestsMoreLGFVDefaultsAreLikely.pdf/00c1bdd1-70c0-9240-12df-850df192c602>.

<sup>20</sup> Jonathan Eckart, "8 Things You Need to Know About China's Economy," World Economic Forum (June 23, 2016) <https://www.weforum.org/agenda/2016/06/8-facts-about-chinas-economy>.

the most dangerous sector of China's overall debt, and if not properly addressed by the CCP, will cause significant negative effects to China's economy.

## **Household Debt**

China's household debt—comprised of mortgage loans, personal loans, car loans, and other lines of credit extended to individuals from financial institutions—has also undergone an extremely rapid increase in the last decade and, if not properly addressed, will have substantial negative effects on China's economy. The Organization for Economic Cooperation and Development (OECD) rated China's household debt at a “moderate” level.<sup>21</sup> However, the Allianz Group, one of the leading integrated financial services providers worldwide, warned that Chinese household debt has reached the “critical” level for emerging markets.<sup>22</sup> For a nation's household debt to be identified as “critical,” its household debt to GDP percentage must measure over 50 percent and have increased more than 10 percent within the last five years.<sup>23</sup> As of February 2019, Chinese household debt measured an all time high of 50.3 percent of GDP and had increased over 19 percent in the last five years.<sup>24</sup> It is this tremendously short time frame in which it has risen and the alarming future projection that makes China's household debt a significant threat to its economic growth. As household debt increases, consumers are more conservative with spending as they have less disposable income.

Even more concerning, as of March 2017, nearly 60 percent of all Chinese household debt was comprised of mortgages and was projected to increase another 20 percent in 2018.<sup>25</sup>

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<sup>21</sup> China Power Team, *China Power*, 3.

<sup>22</sup> Katherine Brandmeir, et al., “Allianz Global Wealth Report 2018,” The Allianz Group (September 26, 2018) [https://www.allianz.com/en/economic\\_research/publications/specials\\_fmo/agwr18e.html](https://www.allianz.com/en/economic_research/publications/specials_fmo/agwr18e.html).

<sup>23</sup> Brandmeir, et al., “Allianz Global Wealth Report 2018”

<sup>24</sup> Trading Economics, “China Household Debt to GDP,” Trading Economics (February 21, 2019) <https://tradingeconomics.com/china/households-debt-to-gdp>.

<sup>25</sup> Hiroshi Murayama, “China's soaring Household Debt Back Beijing into a Corner,” *Nikkei Asian Review* (August 2, 2018) <https://asia.nikkei.com/Economy/China-s-soaring-household-debt-backs-Beijing-into-a-corner>.

This significant lopsidedness places a tremendous predicament on the CCP. At some point, the CCP will have to address this household debt and are likely to find themselves in a lose-lose situation. Either they curb increases in household debt by making it increasingly more difficult to take out a mortgage—thereby causing resentment among the lower class—or lower house prices which will crush those in the middle and upper class who already own homes. Hiroshi Murayama observed that “The growing gap between the haves and have-nots represents one of China’s biggest risks. But while an uprising of the disgruntled poor may be a nightmare for the Communist Party, a rebellion by the middle and upper class could prove equally damaging.”<sup>26</sup> Although not the most dangerous threat to the economy, China’s household debt, if left unattended, could cause significant damage to the economic growth on which China is critically dependent.

### **Government Debt**

The least threatening sector contributing to China’s overall debt crisis is the debt owed by the Chinese central government. Although the level of Chinese government debt has increased significantly since 2008—increasing from 27.1 percent of GDP in 2008 to 47.6 percent of GDP in 2017—it is well nested within its emerging market partners.<sup>27</sup> In 2017, the government debt to GDP percentage for Mexico, India, and Brazil measured 46.4 percent, 68.7 percent, and 74.04 percent respectively, placing China well within the center of the pack.<sup>28</sup> For additional perspective, in 2017 the government debt to GDP ratio of the United States was 97.1 percent.<sup>29</sup>

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<sup>26</sup> Murayama, “China’s Soaring Household Debt Backs Beijing into a Corner,” 2.

<sup>27</sup> China Power Team, China Power, 3.

<sup>28</sup> Trading Economics, “China Government Debt to GDP,” Trading Economics (February 25, 2019) <https://tradingeconomics.com/china/government-debt-to-gdp>.

<sup>29</sup> China Power Team, China Power, 3.

While China's government debt to GDP is the least concern, its total debt to GDP—the summation of its household, corporate, and government debt—and the extremely rapid increase within the last decade forecasts trouble and a need for reprioritization for the CCP. The China Power Project team highlighted that between 2009 and 2015, China's total credit growth averaged about 20 percent per year.<sup>30</sup> An IMF report produced in 2016 noted that “of the 43 economies whose credit-to-GDP ratio grew by at least 30 percentage points in the last five years, 38 of them experienced severe disruptions, manifested in financial crisis, growth slowdowns, or both.”<sup>31</sup> China's total credit-to GDP ratio increased 48.4 percentage points from 2012 to 2017.<sup>32</sup> As a result of this growing debt crisis, China's credit rating has already taken multiple hits across numerous financial service organizations. S&P and Moody's both downgraded China's sovereign credit in 2017, both citing a substantial increase in credit risk due to a significant, prolonged debt increase.<sup>33</sup> While Xi Jinping has acknowledged the severity of the issues and pledged to institute various reforms, a quick fix does not exist.<sup>34</sup> Fixing China's out-of-control lending addiction without severe backlashes to the nation's economy will be extremely difficult.

### **China's Demographic Crisis**

In addition to its looming debt crisis, the CCP has another significant internal stability issue: demography. The demographic landscape of China is undergoing a dramatic change, so much so that it is argued to be entering into a new demographic era.<sup>35</sup> While the most significant demographic phenomenon occurring in China is its rapidly aging population, other issues such as

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<sup>30</sup> China Power Team, *China Power*, 4.

<sup>31</sup> China Power Team, *China Power*, 8.

<sup>32</sup> China Power Team, *China Power*, 8.

<sup>33</sup> Frank Tang, Wendy Wu, and Sidney Leng, “S&P Pours Cold Water on Beijing's Upbeat Economic Narrative,” *South China Morning Post* (September 25, 2017) <https://www.scmp.com/news/china/economy/article/2112257/sp->.

<sup>34</sup> Arthur R. Kroeber, “Xi Jinping's Ambitious Agenda Economic Reform,” *Brookings* (November 18, 2013) <https://www.brookings.edu/opinions/xi-jinpings-ambitious-agenda-economic-reform/>.

<sup>35</sup> Feng Wang, “China's Population Destiny: The Looming Crisis,” *Brookings* (September 30, 2010) <https://www.brookings.edu/articles/chinas-population-destiny-the-looming-crisis/>.

marriage squeeze, migrant worker migration, urbanization, and the destruction of the traditional family construct are also taking place. Unfortunately for the CCP, all these issues are interrelated and will take an extremely long time to fix.

## **Aging Population**

China is getting older at an alarming rate. A massive redistribution of its population is making its way to the top of the population pyramid. As this redistribution increases, so too do the resources required to support them. This increasing resource requirement not only exacerbates China's already looming debt crisis, but also places additional pressure on the CCP. The fundamental demographic transformation taking place in China is so profound, one political economist has described it as a "demographic leap into the unknown."<sup>36</sup> Nicholas Eberstadt provides projections on the fundamentally shifting demographics from 2015 to 2040. In 2040, China will not only have one quarter of a billion more people over the age of 50 than in 2015, but also contain a quarter of a billion less people under the age of 50.<sup>37</sup> Eberstadt also projects that by 2040, the median age in China will be 47, "higher than the median age of any country or territory on the planet as of 2015."<sup>38</sup> Further, by some estimates, by 2030, China's 60 and over population will have increased 13 percent from 2010.<sup>39</sup> Unfortunately for China, an aging population is not the only problem. The entire population structure is also undergoing a drastic change.

## **Shifting Population Structure**

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<sup>36</sup> Nicholas Eberstadt, "China's Demographic Prospects to 2040: Opportunities, Constraints, Potential Policy Responses," Hoover Institution (October 29, 2018) <https://hoover.org/research/chinas-demographic-prospects-2040-opportunities-constraints-potential-policy-responses>.

<sup>37</sup> Eberstadt, "China's Demographic Prospects," 2.

<sup>38</sup> Eberstadt, "China's Demographic Prospects," 2.

<sup>39</sup> Yinan Zhao and Jing Zhao, "China's Next Debt Bomb is an Aging Population," Bloomberg News (February 6, 2018) <https://bloomberg.com/news/articles/2018-02-05/china-s-next-debt-bomb-is-an-aging-population>.

Eberstadt estimates China's working age population to have peaked just prior to 2015 and projects it to decrease over 100 million people by 2040.<sup>40</sup> The specifics of the aging of China's workforce are even more alarming. Breaking Down China's workforce into segments, Eberstadt demonstrates the lagging tail of the workforce population sinewave rearing its ugly head in China. By 2040, the 15-29 year old cohort—the most significant workforce age group—is expected to decrease by 75 million people (roughly a quarter of its original size) and result in a decrease (as a share of total manpower) from 32 percent to 26 percent.<sup>41</sup> China's 30-49 year old cohort—the mid-level managers—are projected to decrease by more than 100 million, which results in a decrease in its share of total manpower from 43 percent to 37 percent.<sup>42</sup> Although the 50-65 year old cohort is the only segment projected to undergo any increase from 2015 to 2040, it too is expected to decrease in total numbers prior to 2040.<sup>43</sup> Unfortunately for China, the post-work population segment—those 65 years and older—is expected to explode. Eberstadt reports China's 65 and older population segment will increase nearly 150 percent: 135 million to 340 million, and that by 2040, China will be a “super aged society with 22 percent of its population over the age of 65.”<sup>44</sup> Further, China's oldest population segment—those 85 years and older—will experience a boom as well, jumping from 1.7 percent in 2015 to 4.9 percent in 2040.<sup>45</sup> Ironically, the negative demographic outlook for China is a direct result of its One-Child policy, which had been intended to deal with a different demographic problem, China's rising population at the time.<sup>46</sup>

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<sup>40</sup> Eberstadt, “China's Demographic Prospects,” 2.

<sup>41</sup> Eberstadt, “China's Demographic Prospects,” 3.

<sup>42</sup> Eberstadt, “China's Demographic Prospects,” 3.

<sup>43</sup> Eberstadt, “China's Demographic Prospects,” 3.

<sup>44</sup> Eberstadt, “China's Demographic Prospects,” 3.

<sup>45</sup> Eberstadt, “China's Demographic Prospects,” 3.

<sup>46</sup> Shibuya citation

As a result of its One-Child policy, China has undergone decades of sub-replacement fertility levels. Replacement level fertility—the level of fertility a country must maintain to sustain its population—is above 2.1 births for every woman throughout her life.<sup>47</sup> Beginning in 1992, China fell below the 2.1 fertility level, hit its lowest recorded level of 1.494 in 1999, and has barely managed to increase its fertility rate by less than 0.2 percent since.<sup>48</sup> Since China has been projected to remain below the replacement fertility level through 2040, by that time China will have undergone nearly a half century of sub-replacement fertility levels.<sup>49</sup> What does this mean for China? Through at least 2040, China will depend on a smaller, younger population to support its larger, aging population which will cause immense strain on China’s already debt-ridden economy.

### **Marriage Squeeze**

Another unintended consequence of the One-Child policy is a gender imbalance and subsequent marriage squeeze. While projections for the coming decades have China’s sex ratio at birth (SRB) disparity decreasing, it will remain well above the global normal.<sup>50</sup> These changes are slow, and the lag resulting from decades of severe gender imbalance will continue for some time. Some estimates predict that as early as 2020, China may have as many as 30 million bachelors unable to marry.<sup>51</sup> This phenomenon has created an entirely new social class

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<sup>47</sup> Tim Searchinger, et al., “Achieving Replacement Level Fertility,” Working Paper, Installment 3 of Creating a Sustainable Food Future (Washington, DC: World Resources Institute) 2013, 1.

<sup>48</sup> The World Bank, “Fertility Rate, Total (Births per Woman),” The World Bank Group (2017) <https://data.worldbank.org/indicator/SP.DYN.TFRT.IN?locations=CN>.

<sup>49</sup> Eberstadt, “China’s Demographic Prospects,” 2.

<sup>50</sup> Eberstadt, “China’s Demographic Prospects,” 5.

<sup>51</sup> Wanning Sun, “My Parents Say Hurry Up and Find a Girl’: China’s Millions of Lonely ‘Leftover Men’,” The Guardian (September 28, 2017) <https://www.theguardian.com/inequality/2017/sep/28/my-parents-sat-hurry-up-and-find-a-girl-chinas-millions-of-lonely-leftover-men>.

within China known as the “bare branches.”<sup>52</sup> This gender imbalance has already distorted social and economic structures as well. Men now have higher expectations to meet if they wish to attract a bride. Having a high-paying job and owning a home or apartment are all prerequisites now. Further, it is not unheard of for a future bride’s parents to charge money just for permission to date their daughter. Some prices have been reported as high as \$30,000.<sup>53</sup> The demand for an apartment or house has also shifted the housing economy as the increase in demand has resulted in an increase in prices. These costs are driving not only the “bare branches” to increase their savings rate, but also their parents as they shift financial priorities to helping their sons buy homes and pay for expensive dating costs. As China’s savings rate is already high, this second order economic effect only exacerbates the issue.<sup>54</sup> As positive research exists on the correlation between marriage squeeze as social and economic instability, China’s growing marriage squeeze will present the CCP yet another significant domestic challenge it must address in order to avoid severe impacts to China’s positive outlook.<sup>55</sup>

### **Expectations and Legitimacy**

Also integral to China’s progress is the ability of the CCP to maintain legitimacy by meeting the expectations of its citizens. A theory regarding the disparity between expectations and reality is the one developed by American sociologists James C. Davies. The “J-Curve” theory of political revolutions argues “revolutions are most likely to occur when a prolonged period of objective economic and social development is followed by a short period of sharp

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<sup>52</sup> Xuan Li, “Pity China’s ‘Bare Branches’: Unmarried Men Stuck Between Tradition and Capitalism,” The Conversation (January 27, 2017) <https://theconversation.com/pity-chinas-bare-branches-unmarried-men-stuck-between-tradition-and-capitalism-68592>.

<sup>53</sup> Sam Judah and Mike Wending, “The Rising Cost of a Chinese Bride Prince,” BBC News (March 6, 2016) <https://www.bbc.com/news/blogs-trending-35727057>.

<sup>54</sup> IMFBlog, “Chart of the Week: China’s Thrift, and What to Do About It,” IMFBlog (February, 26, 2018) <https://blogs.imf.org/2018/02/26/chart-of-the-week-chinas-thrift-and-what-to-do-about-it/>

<sup>55</sup> Lena Edlund, et al., “Sex Ratios and Crime: Evidence from China,” Review of Economics and Statistics 95, No. 5 (December 2013): 1520-1534.

reversal.”<sup>56</sup> China has enjoyed a booming economy the past few decades. China has recovered from Mao’s deadly governance and life today in China is better. However, what happens when the CCP can no longer provide the expected standard of living its population has come to enjoy? What happens when the “bare branches” reach the critical point on the “J-Curve”? Meeting expectations provides legitimacy and the CCP needs this legitimacy to maintain governance. Once that legitimacy is gone or in question, the CCP will be backed into a corner and on the horns of a dilemma. Does it counter with more control or does it loosen its grip on the population? Should the CCP tighten its control, it risks stepping backwards to a time when the leadership in China was more ideologically focused rather than governance focused. If it loosens its grip on the population and implements sweeping liberal reforms, it risks further creep towards a more democratic society, something the CCP absolutely cannot afford to do. Another course of action the CCP could execute would be to replace resentment with Nationalism. By creating an external enemy (or leveraging a current one), the CCP can not only place blame on that nation or organization, but also, by rattling its sabers against them—whether that be diplomatically, militarily, or economically—show its “legitimacy” as a governing body by protecting the people of China. While this course of action may result in increased nationalism and a temporary reprieve from its failure to meet expectations, it will further antagonize the international community already weary of Chinese intentions. Either way, an increasing say-do gap and inability to meet expectations could destroy the solid domestic foundation integral for the CCP to project power globally.

### **Counterargument**

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<sup>56</sup> James C. Davies, “Toward a Theory of Revolution,” *American Sociological Review* 27, No. 1 (February 1962) 5-19.

The counterargument to this thesis—that the rise of China is inevitable because the CCP will be able to mitigate its domestic issues is based on three main arguments: the CCP has so far managed to survive while its communist and socialist brothers have not; the CCP is observant of its neighbors and open to learning, adapting, and experimenting with policy; and the CCP has already implemented policies to address these domestic issues. While those arguments hold merit, they do not address the common thread throughout; these responses by the CCP have only addressed the symptoms and not the underlying causes.

The CCP has managed to survive for 70 years while its communist and socialist brothers have not. Bruce J. Dickson argues they have done so because they have adequately manipulated three elements: repression, legitimation, and co-optation.<sup>57</sup> The CCP, using techniques including “harassing political activities, limiting free speech and organizing, censoring the media and Internet, and engaging in propaganda to shape public opinion,” have successfully repressed or preempted a successful uprising.<sup>58</sup> The CCP has also been dedicated to maintaining its legitimacy through “serving the needs of the people it governs and promoting a particular set of political values.”<sup>59</sup> Completing the trinity, the CCP has also been very canny at co-optation. Dickson further highlights that “As the Party alternated between ideologically motivated goals and development-oriented policies, it alternated between recruiting those skilled in mass mobilization and those with technical expertise.”<sup>60</sup> By transitioning between these elements and applying them at appropriate levels, the CCP has managed to survive and is poised to continue to do so regardless of any internal challenges.

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<sup>57</sup> Bruce J. Dickson, “The Survival of the Chinese Communist Party,” *The Washington Quarterly* 39, No. 4 (Winter 2017): 27-44.

<sup>58</sup> Dickson, “Survival of the Chinese Communist Party,” 29.

<sup>59</sup> Dickson, “The Survival of the Chinese Communist Party,” 33.

<sup>60</sup> Dickson, “The Survival of the Chinese Communist Party,” 39.

The CCP's ability to learn has enhanced its ability to adapt social and economic policies in response to the changing environment within China. This capability has been the integral piece to the CCP's ability to maintain political control while at the same time allowing just enough social freedom to meet rising Chinese expectations. Wen Hsuan Tsai and Nicola Dean present Roland Robertson's idea of "reflexive modernization" when they posit the CCP, "after analysis and interpretation of foreign experiences, is able to pick and choose those concepts which are useful to its own modernizing aims."<sup>61</sup> The CCP's effective control of China's population through repression, legitimation, and co-optation in addition to its willingness to learn and adapt policies to meet rising expectations form a significant counterargument. However, most of the policies implemented by the CCP only serve to address the symptoms of the underlying root issues. As such, they will only continue to provide "band-aids" to China's serious domestic issues. That may be the best and only option for the CCP right now as they attempt to meet expectations while doing their best to hold on in the face of numerous significant problems—problems that due to their nature are going to take a significantly long time to solve anyways. However, the CCP is taking a huge risk betting with time, specifically under the assumptions that their efforts will reduce the current expectation say-do gap.

### **China's Three Courses of Action and Potential US Reactions**

Firmly securing its position as the world's second largest economy and, despite significant international consternation, boasting an expanding Belt and Road Initiative, China has undoubted global influence.<sup>62</sup> However, despite its recent economic performance and significant

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<sup>61</sup> Wen-Hsuan Tsai and Nicola Dean, "The CCP's Learning System: Thought Unification and Regime Adaptation," *The China Journal* No. 69 (January 2013): 89.

<sup>62</sup> For expanding Belt and Road Initiative, see: Valbona Zeneli, "Italy Signs on to Belt and Road Initiative: EU-China Relations at Crossroads?" *The Diplomat* (April 3, 2019) <https://thediplomat.com/2019/04/italy-signs-on-to-belt-and-road-initiative-eu-china-relations-at-crossroads/>. Italy was the first European and G-7 country to sign on to China's debated Belt and Road Initiative.

foreign policy achievements, the CCP has failed to adequately address the dangerous internal domestic issues festering within China. If left unaddressed, these domestic issues pose a serious threat to China's continued rise and the CCP's legitimacy as its governing body.

Unlike Mao's ideologically driven legitimacy, the CCP has heavily relied on its ability to bring about impressive socio-economic enhancements as the foundation of its legitimacy. However, as China's economy slows and the CCP fails to meet China's growing expectations, it may have to look elsewhere to regain its legitimacy. The three courses of action addressed in this paper the CCP could take to maintain or enhance its legitimacy prior to China reaching the critical point of the J-Curve follow. The first course of action the CCP could take would be to maintain—as part of its grand strategy—a foreign policy linked with its domestic policy. The CCP would use its strategic foreign policy initiatives to support its domestic requirements. The second course of action the CCP could take—to disguise or take focus away from its domestic issues—would be to increase its international saber rattling to ignite an increased level of nationalism within China. This increased level of nationalism will supplement, if not replace, the CCP's socio-economic source of legitimacy. The third course of action the CCP could take would be—in the honest attempt to adequately address its threatening domestic issues—place the long-term health of China as its first priority and refocus its efforts inward. In response to all three courses of action, the United States must be prepared to react in a manner that meets its national security goals. It is important to note that while the United States' military reactions to the proposed CCP courses of action can vary to some degree, its priorities should remain innovation, readiness and increased lethality in order to widen the shrinking capabilities gap between it and China.

### **CCP Maintains its Grand Strategy**

Forging into the future, in order to maintain its legitimacy as the governing body of China, the CCP will link its calculated foreign policy initiatives towards achieving its domestic requirements. This strategy will be centered on two main efforts: maintain its power over the people of China and systematically acquire more power than its international competitors.<sup>63</sup> Having established China as a global power, the CCP will use this influence to continue to become not only a relevant member, but also a powerful, influential voice within as many global institutions as they can. Their end state will be to ensure the policies established by these institutions do not challenge their national security goals, but rather advance them.<sup>64</sup>

Politically, the United States should execute a more robust balancing strategy against China. It should deepen its partnerships with key, strategic partners and allies in the Indo-Pacific region. The United States should, using the other instruments of national power, minimize any dependency member nations in global institutions have on China.

Militarily, the United States must reinforce its focus on innovation, readiness, and lethality to not only serve as a legitimate deterrent, but also a capable force should conflict arise. As a powerful, legitimate military will assure allies and partners, the United States must demonstrate its commitment to a robust, long-term military presence in the Asia-Pacific region.<sup>65</sup> By enhancing long-term military partnerships and cooperation with strategic allies, The United States will demonstrate its resolve to those nations looking to balance against China. Militarily, the United States must also win the race to establish itself as the founding nation in new areas of potential power such as space and cyber. While both China and the United States already pursue

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<sup>63</sup> Robert D. Blackwill and Ashley J. Tellis, "Revising U.S. Grand Strategy Toward China," Council on Foreign Relations Special Report No. 72, March 2015; [https://cfrd8-files.cfr.org/sites/default/files/pdf/2015/04/China\\_CSR72.pdf](https://cfrd8-files.cfr.org/sites/default/files/pdf/2015/04/China_CSR72.pdf); 7.

<sup>64</sup> China's membership in the International Monetary Fund, The World Bank, and especially as a veto member of the United Nations Security Council serve as examples.

<sup>65</sup> Robert D. Blackwill and Ashley J. Tellis, "Revising U.S. Grand Strategy Toward China," 5.

advances in those areas, the nation to control access will always be better than the one having to ask for it.<sup>66</sup>

Economically, the United States does not differ from China with respect to its significant amount of debt. Initiative to tackle that challenge, for both parties, will result in increased capital to devote to other strategic initiatives. However, to balance against China, the United States should eliminate as many barriers as possible to producing domestic economic growth. It should also reestablish itself in trade agreements within the Asia-Pacific region, such as the Trans-Pacific Partnership and establish new ones that exclude China.<sup>67</sup>

### **CCP's Turn to Nationalism and the US Response**

While the governing body of liberal democracies derive most of their legitimacy through legal means, governing bodies of communist and authoritarian countries are forced to manipulate a variety of sources to maintain legitimacy. Le Hong Hiep, fellow at the Institute of Southeast Asian Studies, identifies “Marxist ideology, socialist goals, popular revolution, charismatic leaders, official nationalism, and socio-economic performance as the main sources of legitimacy for communist-type regimes.”<sup>68</sup> Of the many sources, Le identifies socio-economic performance as “the single most important source from which communist regimes derive their legitimacy.”<sup>69</sup> Socio-economic performance is vital to communist regimes because it represents the entire purpose of their existence. Citizens of communist countries trade away civil liberties in exchange for promised social welfare. The CCP has derived its legitimacy from the significant levels of socio-economic performance within China. However, as China’s economy slows and

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<sup>66</sup> Mary Dejevsky, “The Space Race is Back On – and is China in the Lead?” *The Guardian* (January 3, 2019) <https://www.theguardian.com/commentisfree/2019/jan/03/space-race-china-change-4-us-russia-moon>

<sup>67</sup> Robert D. Blackwill and Ashley J. Tellis, “Revising U.S. Grand Strategy Toward China,” 5.

<sup>68</sup> Le Hong Hiep, “Performance-based Legitimacy: The Case of the Communist Party of Vietnam and Doi Moi,” *Contemporary Southeast Asia* Vol. 34, No. 2 (2012); 151.

<sup>69</sup> Le Hong Hiep, “Performance-based Legitimacy,” 151.

its domestic fissures widen, the CCP faces a tremendous loss of legitimacy should it not be able to meet its over 1.3 billion citizens' expectations. As the Party's absolute number one priority is to protect the Party, it will be forced to derive its legitimacy from other sources. One way it will accomplish this is to rattle its sabers internationally in the attempt to incite nationalist sentiment within China. To do this, the CCP will increase international tensions related to a specific "hot topic" or "existential threat" for China, such as Taiwan or the South China Sea.<sup>70</sup>

Unlike many adversarial courses of action—where the most likely and most dangerous courses of action are not the same—this course of action is both the one most likely to occur and the one most dangerous to the United States. The CCP has already demonstrated an almost predictable schedule of saber rattling following an increase in domestic disturbance.<sup>71</sup> Where it is the most dangerous to the United States is not in the direct action taken by the CCP, but in the possibility of misjudgment and subsequent escalation Erin Baggott Carter describes as a misinterpretation of diversionary actions and revisionary actions.<sup>72</sup>

In response to the CCP's saber rattling, it is imperative the United States correctly identify whether the CCP's actions are diversionary or indeed revisionary. The incorrect response to either risks rapid escalation or loss of critical ground in a great power competition with China. For the purpose of this paper, only the United States' response to the CCP's diversionary actions will be addressed.

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<sup>70</sup> For examples of the CCP's diversionary tactics see: Frank Fang, "Beijing Seeks to Divert Attention Away from Internal Crisis with Saber-Rattling Remarks Against Taiwan," *Epoch Times* (January 10, 2019) [https://www.theepochtimes.com/beijing-seeks-to-divert-attention-away-from-internal-crisis-with-saber-rattling-remarks-against-taiwan\\_2761399.html](https://www.theepochtimes.com/beijing-seeks-to-divert-attention-away-from-internal-crisis-with-saber-rattling-remarks-against-taiwan_2761399.html); George Yin, "Domestic Repression and International Aggression? Why Xi is Uninterested in Diversionary Conflict," *Brookings* (January 22, 2019) <https://www.brookings.edu/articles/domestic-repression-and-international-aggression-why-xi-is-uninterested-in-diversionary-conflict/>; and Erin Baggott Carter, "Diversionary Aggression in Chinese Foreign Policy," *Brookings* (January 22, 2019) <https://www.brookings.edu/articles/diversionary-aggression-in-chinese-foreign-policy/>.

<sup>71</sup> Erin Baggott Carter, "Diversionary Aggression in Chinese Foreign Policy," 3.

<sup>72</sup> Erin Baggott Carter, "Diversionary Aggression in Chinese Foreign Policy," 3.

Politically, the United States should respond to the CCP’s saber rattling by reaffirming its commitment to its allies and partners and increasing its support to the current rules-based international organizations. The United States should continue to press the CCP on its behaviors counter to the current rules-based international organizations. It should press the CCP not only on issues within China—such as its manipulation of its economy, human rights violations, and increased repression of its citizens—but also on its behaviors outside of China, such as its use of “debt-trap diplomacy” and the stealing of intellectual property. The United States, while not being overtly belligerent, should take every opportunity to highlight the issues the CCP is trying to disguise.

The United States’ military response should be twofold. First—backed by strong, and most importantly, unwavering support from Washington—the United States should respond to the CCP’s saber rattling with increased joint and coalition capability building initiatives. While this response requires great caution as to not initiate a security dilemma, it is still important to meet CCP aggressiveness with a strong coalition response. Second, as the CCP’s saber rattling has predominantly taken place in the “grey zone,” the United States should develop a more proactive approach to eliminating CCP maneuver space within the grey zone. This should be done by working with partner nations and allies to enhance interoperability and response capability. The United States, through continued and determined action, must enhance its military partnerships with coalition nations. The CCP’s aggressive actions must be met with a resolute response and demonstration of readiness.<sup>73</sup> While this may not curb the CCP’s saber

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<sup>73</sup> James Goldrick, “Grey Zone Operations and the Maritime Domain,” The Strategist: Australian Strategic Policy Institute (October 30, 2018) <https://www.aspistrategist.org.au/grey-zone-operations-and-the-maritime-domain/>; for switching to a more proactive response see: John Schaus, Kathleen H. Hicks, Heather A. Conley, and Michael Matlaga, “What Works: Countering grey Zone Coercion,” CSIS (July 16, 2018) <https://www.csis.org/analysis/what-works-counter- gray-zone-coercion>, and Laura Zhou, “US Shift on South China Sea ‘Grey Zone’ Aggression Signals Stronger Response Ahead,” South China Morning Post (February 8, 2019) <https://www.csis.org/analysis/what-works-counter- gray-zone-coercion>.

rattling, it will solidify the coalition against it and make it harder and more expensive for the CCP to demonstrate a real threat. It may also increase internal divides within the CCP centered on the Party's overstepping foreign policy actions.<sup>74</sup>

Economically, the United States should meet increased CCP aggression with swift and hard economic sanctions accompanied by the narrative that the CCP can bring an end to them all with changed behavior. Further, the United States should not respond with sanctions by itself. Strong economic sanctions should be in coordination with and enhanced by its allies and partners. A collective of economies will not only present the CCP with an exponentially more difficult problem, but will also allow the second and third order effects from those sanctions to be spread across a larger environment, not just the United States.<sup>75</sup> Additionally, the United States should initiate legal reforms to force the cost of innovation back on the CCP, rather than let it continue to steal intellectual property and innovative trade secrets through forced technology transfers. With the U.S. Trade Representative reporting an estimated annual loss to China up to \$600 billion as a result of intellectual property theft, a significant decrease in that number would not only force another cost on an already debt ridden economy, but also allow that money to remain in the United States.<sup>76</sup> For perspective, the proposed Department of Defense budget for fiscal year 2020 is \$713.8 billion.<sup>77</sup>

## **CCP's Look Inward**

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<sup>74</sup> Tara Francis Chan, "Factional Warring and Failed 'Coups' May be the Reason Xi Jinping Wants to Rule China Forever," Business Insider (March 11, 2018) <https://www.businessinsider.com/xi-jinping-ended-term-limits-because-of-failed-coup-2018-3>.

<sup>75</sup> Chad P. Brown, "Why the U.S. Needs Allies in a Trade War Against China," Harvard Business Review (December 11, 2018) <https://hbr.org/2018/12/why-the-u-s-needs-allies-in-a-trade-war-against-china>

<sup>76</sup> Erik Sherman, "One in Five U.S. Companies Say China has Stolen Their Intellectual Property," Fortune (March 1, 2019) <http://fortune.com/2019/03/01/china-ip-theft/>.

<sup>77</sup> United States Department of Defense, "DOD Releases Fiscal Year 2020 Budget Proposal," <https://dod.defense.gov/News/News-Releases/News-Release-View/Article/1782623/dod-releases-fiscal-year-2020-budget-proposal/>.

The other course of action the CCP could take would be to honestly address its threatening domestic issues by placing the long-term health of China as its first priority. Although this course of action is the least likely, it is the most advantageous to the United States. This course of action would involve the CCP revectoring its spending from its expansive foreign policy to address its domestic issues. Instead of igniting another source of legitimacy, the CCP would be trying to gain ground in the socio-economic environment.

Politically, the United States should reward the CCP for its good governance of China. Releasing pressures on China to allow it the time and space to shore up its domestic issues would not only help China, but also lesson the tensions in the Sino-United States relationship.

By relaxing exercises and continual enforcement of a free and open Indo-Pacific, the United States military could decrease its threat against the CCP and provide it the maneuver space to address its internal issues. As the CCP looks inward, the United States should prioritize diplomacy to build and strengthen relationships in the region.

Economically, the United States should be good steward towards China and ease any sanctions that may be in place as long as the CCP follows through with reform. It should also take advantage of the decrease in tensions to ensure its policies and leadership within coalitions represent core interests of the United States, not just anti- or counter-China policies.<sup>78</sup>

## **Conclusion**

Fueled by its incredible economic performance, China has re-emerged as a significant influencer on the global stage. However, daunting domestic issues centered on its looming debt crisis and fundamental demography shift threaten to bring China's rise to a hard stop should the

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<sup>78</sup> Leland Miller, "Rethinking U.S. Economic Policy Towards China," in *Choosing to Lead: American Foreign Policy for a Disordered World* The John Hay Initiative (2015) <http://www.choosingtolead.net/rethinking-us-economic-policy-toward-china>

CCP leave them unaddressed. Admittedly, these issues are of significant size and complexity and it may be all the CCP can do to address them is to simply provide solutions to their symptoms as they arise. Unfortunately for the CCP, barring any cataclysmic global event, that strategy has a time limit as the rising expectations of its over 1.3 billion citizens go more and more unfulfilled. As shown, the CCP does have options to either disguise those issues or actually address them, but the truth remains: China is plagued by significant domestic issues that if not properly addressed render the continued rise of China anything but inevitable.

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