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**Leadership and the Mandate of Heaven: Political
Risk in China**

By Charles RARICK ^{a†} & Kasia FIRLEJ ^b

Abstract. China has experienced very impressive economic growth over the past three decades and has raised millions of people out of poverty in a short period of time. This economic miracle has brought prosperity to millions and extreme wealth to some. China now faces slower growth and a number of other obstacles which may undermine its stability. This paper explores the problems facing modern China by looking back at history and using current social science research as a predictor of potential unrest and political instability.

Keywords. China, Political risk, Globalization, Geopolitics.

JEL. J11, F51, O53.

1. Introduction

Leadership has always been an important part of Chinese civilization. Ancient China saw the rise of great leaders and philosophers who continue to shape modern Chinese culture. The Sage Kings of High Antiquity, Yao and Shun, who lived over 2500 years ago, set the stage for good leadership. Leadership was selfless and always devoted to the welfare of the people. The early Chinese philosopher, Laozi, proposed that that nature existed in absolute harmony and mankind should also seek to live in harmony. Laozi provided a humanistic approach to management and leadership which has been fundamental in shaping generations of philosophical, political, and religious thinking in China. During the Imperial Period of Chinese civilization school children were taught to pay respect to Confucius and recite his sayings daily. With the fall of the imperial system, Confucian teachings were eliminated by the communist regime but the values never left the Chinese psyche. Confucian values mandate first a duty to society. Individual needs are not seen as important as the needs of the group and individual gain at the expense of the country is seen as undesirable. Individuals, including leaders should act in a manner which is beneficial to all. Leaders who act contrary to the welfare of the people are subject to rebellion and harsh sanctions. Early in Chinese history the concept of the Mandate of Heaven was developed. This belief is consistent with the early Chinese philosophers and the overall view of leadership within China. The Mandate of Heaven is the political and philosophical belief that supernatural forces have bestowed legitimacy on a ruler, but that legitimacy can be

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withdrawn when things are not going well for the people (Guo, 2003). The withdrawal of the Mandate of Heaven can even take the form of a revolution. When the welfare of the people declines, the “Son of Heaven” or ruler loses the mandate to rule and a new social order can be created. During the modern era China has seen a number of rebellions and revolutions when leadership of the country was perceived as illegitimate and questioned by the people. After more than three decades of economic and social gains, a number of factors are emerging, which can once again give way to dramatic changes in the political structure of China and cause its political risk to rise. This paper proposes that the threats to China’s continued stability and leadership are significant and that political risk is rising in China.

2. Declining economic growth, high expectations, and inequality

For a number of years China enjoyed double-digit economic growth. In recent years that growth has slowed as the economy expanded. Achieving high levels of economic growth can be easier in a less-developed country with a low GDP than in a middle-income country with a high GDP. China now finds itself in the position of attempting to maintain growth levels which may not be sustainable.

With high economic growth in China came a rise in expectations. When Deng Xiaoping declared “to get rich is glorious” many Chinese saw a bright future ahead. Many have experienced the benefits of economic reform, moving from the farm to the factory in order to assemble products for export. While the work was less than ideal, it was better than life in rural China and offered the promise of a more prosperous future. Many Chinese exchanged bicycles for automobiles and rural living for high-rise apartments. Not everyone, however, has been able to make significant economic gains. With economic growth slowing and the realization that expectations may not be realized, China is entering a potentially dangerous time. When high expectations are not realized and income is very unevenly distributed, the probability of social unrest increases.

American sociologist, James Davies, proposed the J Curve to explain the conditions that could produce a revolution (Davies, 1962). When a society experiences periods of significant economic and social gains followed by significant declines in those gains people are much more likely to rebel. As can be seen in Figure 1, some gap between expectations and actual outcomes can be tolerated but as the gap increases the potential for revolution increases.

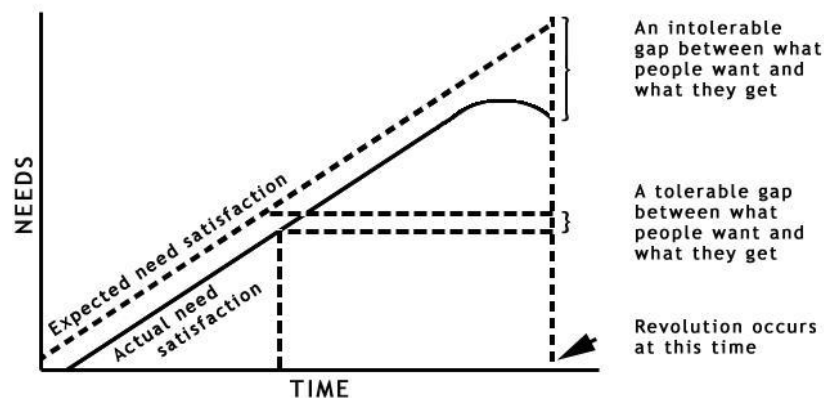


Figure 1. Davies J Curve

Source: Davies, 1962

Income inequality in China rose dramatically from the mid-1990s until 2008 (Li & Sicular, 2014). Since 2008 income and wealth inequality have not risen as rapidly, however, China still possesses one of the world's highest Gini coefficients with the wealthiest one percent of the population owning one-third of the country's wealth (Wildau & Mitchell, 2016). While income inequality may be inevitable in a country as it advances economically (Pilling, 2014), the extreme wealth differential in China may have a greater impact on social stability than in other countries. The Kuznets curve hypothesis predicts that income inequality will first increase, and then decrease as a developing country continues to grow economically (Kuznets, 1955). While it may take longer than expected, China does not appear to be following the Kuznets's hypothesis. Wu & Yao (2015) propose that the weight of state ownership in China is an inhibiting force in bringing about income inequality. Whatever the reason, income inequality is increasing in China and brings the potential of social disharmony.

Wealthy Chinese flaunt their riches on social media, especially the "fuerdai" or children of wealthy parents. The fuerdai, well-known among the Chinese people, pride themselves on displaying their wealth through luxury automobiles, designer goods, and expensive trips abroad. This generation of wealthy children of the privileged live in contrast to the vast majority of the Chinese population. China has been able to withstand poverty, as long as everyone was poor, however, the increasing gap between the wealthy and poor presents a problem for Chinese stability. Increasingly variation in wealth among the people is not helpful to societal harmony, especially in a society in which social harmony is highly valued.

While incomes in China have risen overall, the percentage of the population that sees itself as middle class has fallen (Osborne, 2016). While more Chinese have attained middle class status, the perception of their economic well-being may be tainted by comparisons with the fuerdai. Lorentzen & Scoggins (2015) found that different forms of "rights consciousness" exist in China and that changes in values and shared expectations were most significant in destabilizing China. In a collectivist country such as China, differing values and expectations have the potential to produce more social unrest than perhaps what is found in individualist countries.

The tunnel effect theory of Hirschman & Rothschild (1973) also predicts trouble ahead for China. The tunnel effect theory can be explained by the example of a traffic jam in a tunnel. All cars are stopped and not moving forward. If a driver in one lane notices that cars in another lane are now moving he/she becomes happy as it looks like they will move forward as well. If the driver's lane continues to stay stationary the happiness of the driver decreases. As the other lane continues to move the driver becomes frustrated and eventually will resort to illegal means to move ahead. The example represents income inequality. In the beginning when incomes begin to rise for some there is happiness as people assume that their incomes will rise as well. As others continue to advance economically, the less fortunate begin to feel resentment. Wang & Luo (2014) studied the impact of income inequality and happiness in China and concluded that the tunnel effect was occurring in China, both in rural and urban areas of the country.

3. Globalization, a taste of freedom, and foreign relations

There is no doubt that China has benefited from globalization. Once a country which suffered massive starvation during the "Great Leap Forward" policy years, China has moved to center stage in economic, political, and military terms. China is a country that has had an impressive transformation in a very short period of time. Globalization and market reforms have served China well. China sends many

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students abroad to universities to study in order to build its human capital stock, yet in some ways the country still attempts to maintain the status of a closed or restricted society. China censors all forms of media including newspapers, television, radio, books, and the Internet. Chinese censors block thousands of Websites, including globally popular social media sites. In an attempt to maintain “correct thinking” the government blocks anything coming into the country which may challenge the power of the state.

Globalization which benefits China economically is multidimensional and the ability of the government to stop the non-economic aspects of globalization are unlikely to succeed. Chinese students studying abroad are exposed to all the freedoms of the host countries and the use of proxy servers has allowed many Chinese in China to access Internet sites prohibited by the government. China is opening and will most likely continue to open further, regardless of the attempts of the government to stop some of this openness. A taste of freedom in a closed society can be a dangerous thing for the power structure in charge.

According to Ian Bremmer (Bremmer, 2006), social stability in a county has a curvilinear relationship with a society’s openness. In what may be referred to as the second J Curve, Bremmer proposes that a closed society, such as North Korea, generally can maintain social stability but as a country opens up somewhat to the world it may experience social disruption (Figure 2).

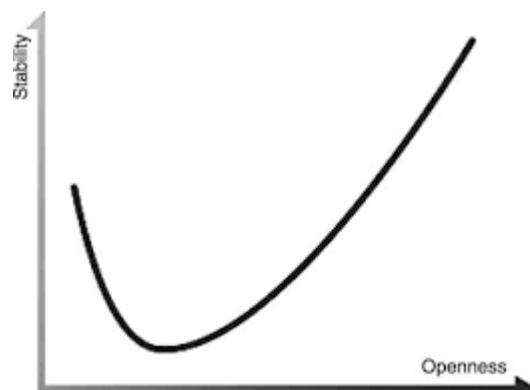


Figure 2. Bremmer J Curve
Source: Bremmer, (2006).

For many years in China’s history the country was a closed society, ruled by either emperors or dictators such as Mao Zedong. With the opening of China to outside influences the country has moved down Bremmer’s J Curve towards less stability. Chinese government attempts to block outside influence through media and Internet content may be futile. As the Chinese experience greater freedom and expose to the outside world questions about the rule of China may become an important issue for the Chinese Communist Party (CCP). The response of the government in recent years has been to crack down on dissenters.

According to Matsumura (2013), China has increasingly been using military force to deal with civil unrest at home. Increased military use at home and abroad have raised some concerns about the ability of China to become a truly modern and developed country. There are also concerns about the motive for such action. In both cases the increased military action may be motivated by maintaining power of the CCP and not necessarily the welfare of the Chinese people. China’s territorial claims in the South China Sea represent the increased use of military power and

present a significant destabilizing event in the region, and beyond. China's relationships with countries in the region have suffered as it moves forward with its claim of ownership of almost all of the South China Sea and being in control of that vital trade route. Disputes with Vietnam, the Philippines, Malaysia, and Brunei over islands in the South China Sea, along with the dispute with Japan over the Diaoyu/Senkakay Islands, have heightened tensions and decreased regional cooperation. China is aggressively engaging in island building in the South China Sea, which appears to have strategic military importance to China. Not only have foreign relations with its neighbors suffered as a result of this action, but relations with the United States and its allies have suffered as well. Both Japan and the Philippines have a mutual defense treaty with the United States. This means that matters could become quite complicated if military action would be undertaken in the region. The South China Sea is important for its fishing industries, oil and gas reserves, and most importantly, for its shipping lanes.

The motive for the land claims could be to improve China's military power in the region as well as to improve the government's image at home. The dispute with Japan helps fuel nationalist pride and the capturing of islands in the South China Sea gives the Chinese a feeling of being a true superpower in the world. In addition to the diplomatic tensions in the region, China has not improved its image to the rest of the world with cyber theft activities, perceived unfair trade practices, and an unwillingness to contribute its fair share when global relief efforts are needed. While all of these activities may bolster the Chinese government's image at home, it may result in serious complications in China's relationship with the rest of the world.

4. Unfavorable demographics and labor unrest

For years China has enjoyed the benefits which have come from low wage levels. China had a relatively young and large workforce which allowed it to attract large foreign investment. With an aging population, due to the long-standing one-child policy, China's population of young workers is in decline and will continue that pattern in the coming years (Figure 3). While the one-child policy has been eased recently, until new births reach employment age labor issues will continue to be a concern for China. A shortage of workers means that employees can put greater pressure on employers for wage increases, and as a result, China has already begun to concede some defeat to lower wage countries such as Vietnam. The population of many Southeast Asian countries continues to rise and most have an overall more youthful population than China. Transitioning away from inefficient state-owned enterprises and placing that labor pool in a more efficient sector may help with some of the labor shortage.

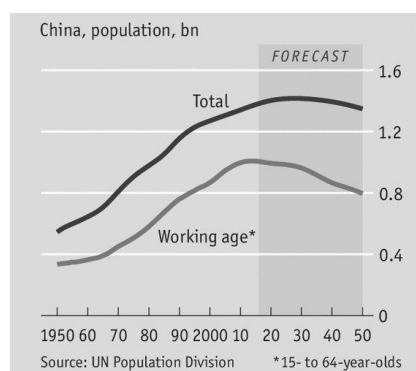


Figure 3. *China's Declining Workforce*

Source: The Economist, April 30, 2016

In the meantime labor unrest has been an increasing concern in China. Increased labor protests including strikes and lockouts are occurring with increased frequency, and there is a real concern about the move by the Chinese government to begin to dismantle some state-owned businesses. Inefficient state-owned businesses have been producing excess quantities of steel, cement, and other goods for which there is no market (Hernandez, 2016). Dismantling these companies could result in millions of displaced workers if not handled properly. Politics plays an important role in business in China and connections are as important, perhaps more important than efficiency and results. Boubakri, Mansi, & Saffer (2013) found that politically connected firms engage in more risky investment choices. Political connections and corruption can be beneficial in the short-term, however, the overall results may not be favorable to either individual companies or countries. The political dynamics of Chinese business, especially relative to state-owned enterprises is complex, and appears to be poised for uncertain change.

5. Strained financial system

Much of the world experienced financial pain in 2008 as the global financial system reached a crisis level. China, like many countries, eased monetary policy and its debt increased. By 2014 China had already amassed a total debt load of \$28 trillion (government, corporate, and household) and that number continues to increase. Private non-financial debt as a percent of GDP has greatly increased since 2008 and continues to rise (Figure 4). Attempts to deleverage the economy and maintain sufficient economic growth has presented a policy contradiction for the government, which is problematic (Curran & Tu, 2015). The stability of the banking system is also a concern. The tendency of the government to bail out failing banks and state-owned enterprises represents a moral hazard, which can increase reckless behavior and make the problem worse.

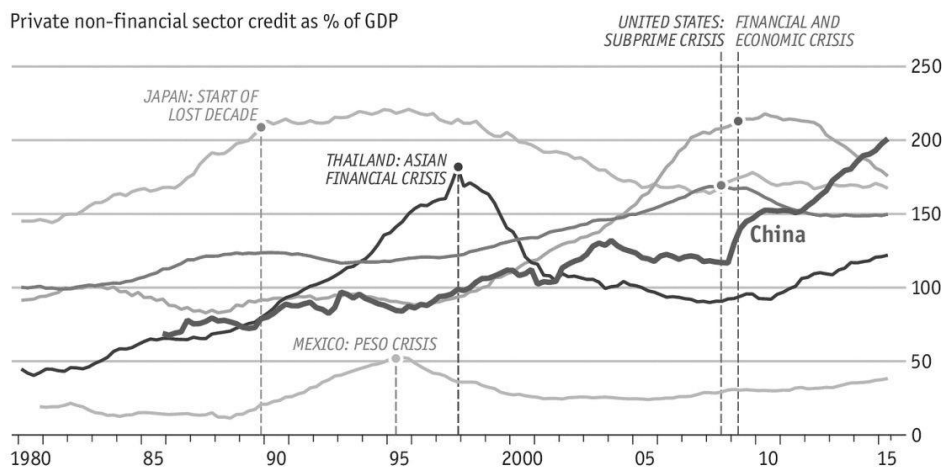


Figure 4. China's Increasing Debt Burden

Source: *The Economist*, March 9, 2016

In addition to the debt problem facing China, fears of the housing market have emerged. There have been concerns about a housing bubble in China, especially in major cities such as Shanghai and Shenzhen where prices have soared. The possible property bubble is compared to the stock market bubble where investors fueled a market due to a fear of missing out as prices rose. Starting in June of 2015 the Shanghai Composite Index lost half its value in a two month period of time

(Scutt, 2016). China survived the stock market crash and could survive a property market crash as well and maintain financial stability, however, increasing debt pressures as well as other concerns may produce a cumulative effect which is problematic for economic and political stability.

6. Other factors

In addition to issues of slowing economic growth and increased expectations, rising debt, and unfavorable demographics, China faces other issues which can promote social instability. While the vast majority of China's population is ethnically Han, there are other ethnic groups within China which are often at odds with the government. China has not treated its ethnic minorities well (Tuttle, 2015) and significant tensions exist between the Han and the Uyghurs, Tibetans, and others. Ethnic (and to a less extent religious) tension will most likely continue to be a source of disharmony in China in the foreseeable future. In addition to ethnic tensions, China has a very significant imbalance in its male-to-female ratio. After decades of a one-child policy, and a cultural preference, China has one of the most imbalanced gender populations in the world. In China the sex ratio is approximately 120 males to 100 girls. A disproportionately large male population can lead to increased aggression, both domestically and abroad (Xie, 2015).

With increased industrialization China moved forward in manufacturing with little concern about the environmental impact. Air pollution, water pollution, and solid waste disposal have reached alarming levels in China, not only endangering the health of its citizens, but causing distrust between its citizens and the government. China must address the environmental issues, in addition to improving institutional transparency, and more effective foreign relations in order to become the country it seeks to become (Lane, 2013). The lack of concern for the environment has helped China move forward economically but the short-term gains will be offset by the long-term negative externalities of this approach.

7. Conclusion

China faces a number of challenges. Perhaps most significant is the income and wealth gap found in the country. Wang, Wan, & Yang (2014) have proposed that income inequality in China could be reduced by changing the hukou system in China. This system of household registration limits the migration of people in China from the rural to urban areas of the country where there is greater opportunity. Changes to the hukou system and/or providing better transportation, telecommunications, and education in the more rural areas of China would be helpful to reducing the income equality of the country. While many Chinese have benefited from the country's economic surge, the growth has been uneven and has favored the coastal regions of the country. Without policies which develop the whole of China, the imbalance in income and wealth will present a potentially destabilizing force for the country. Reducing the importance of state-owned enterprises in a responsible manner, managing debt, providing greater transparency and freedom, moving the economy away from low-wage, labor intensive industries, better environmental management, and better relations with the rest of the world could all help reduce some of the problems China now faces. None of these challenges will be easy to solve.

Current President Xi Jinping has been a force in attempting to strengthen China's national spirit through foreign policy, corruption reform, and suppression of voices which threaten national harmony. While supporting a market economy, to some extent, he has maintained significant state control over most aspects of Chinese life (Economy, 2014). Since becoming president in 2012, Xi has stressed

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the importance of maintaining the “correct ideology” and returning to the Marxist foundations of Chairman Mao. Attempting to balance this ideology in a market economy presents significant pressures and will be challenging. China may have come too far in terms of economic freedom and openness to return to the past, however, one ideology may persist. If the significant problems facing China cannot be resolved and the welfare of its entire people cannot be maintained, the Mandate of Heaven may once again be invoked. Current Chinese leaders may be well advised to return to the leadership approach of the very early leaders and philosophers as they attempt to move China ahead in the modern world.

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