

## China: A Troubled Dragon

Conn Hallinan | May 11, 2006

The image of China in the Western press is less the dragon of the Celestial Kingdom than J.R.R. Tolkien's Smaug, a beast of enormous strength and cunning, ravaging oil markets in Africa, copper ore in South America, and uranium deposits in Australia. "The world begins to feel the dragon's breath on its back," intones the *Financial Times*.

Even dismissing the media's hyperbole, the creature is impressive. Since 1990, its exports have climbed 1,200%. Each year it turns out twice as many engineers as the United States. Its central bank has \$710 billion in currency reserves. Its growth rate was 10.2% last quarter and has averaged 9.8% for the past 12 years. It has the biggest mall in the world.

The capitalist dragon has created great wealth and lifted hundreds of millions out of poverty. But the Chinese leadership is discovering a downside to this narrative, one that is generating a growing social crisis for a huge section of the population.

For all its vaunted power, the dragon is troubled.

According to the China Poverty-Relief Fund, some 30 million of its people live in absolute poverty, defined as not having enough money for food or clothes. Another 60 million make less than 28 cents a day. Income for rural Chinese—where 800 million of China's 1.3 billion people live—is one-third of those in urban areas, a gap, according to government studies, that threatens to widen over the next half decade.

The official *Xinhua News* reports that the top fifth of China's population corners 50% of the country's total income, while the bottom fifth takes home

just 4.7%. In 25 years, China has gone from a nation with one of the smallest income disparities in the world to a country with one of the greatest.

"The income gap, which has exceeded reasonable limits, exhibits a further widening trend," *Xinhua News* wrote in an editorial last fall. "If it continues this way for a long time, the phenomenon may give rise to various sorts of social instability."

That "instability" is already a reality. Whipsawed by a collapsing social security net, a vanishing health-care system and, until recently, a market-focused, tone-deaf government, millions of Chinese have taken to the streets. In 2004, there were 74,000 such "incidents" involving almost four million people, a seven-fold increase in less than a decade. Petitions to redress grievances reached an all time high in 2005.

The growing disparity between rural and urban income was a major focus of last month's National People's Congress, where Prime Minister Wen Jiabao committed the country to closing the gap and creating a "new socialist countryside." He told delegates to the weeklong meeting, "We need to respect the right of the farmers to have their own livelihood. We need to deliver tangible benefits to the farmers."



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But while the new five-year plan is long on rhetoric, its spending goals are modest, to say the least. The government will pump \$42.3 billion into the countryside. But as a percentage of total spending, that is only an increase of .1% over last year, and less than the government spent in 2004. It also represents only 8.9% of total government spending, in spite of the fact that tax revenues rose 20% in 2005.

The Congress did vote to phase out many agricultural taxes, along with school fees and tuition for required schooling, but those will only amount to about \$19 a year, which will hardly bridge the gap. The average city dweller earns about \$1,000 annually, while his or her rural counterpart makes slightly more than \$300.

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The state of China's once all-embracing healthcare system was also a major concern for the Congress.

The government will beef up health spending, most of it to rebuild community health centers in China's major cities by 2010. Those clinics were largely dismantled in the 1980s, a cost-cutting

measure that has come back to haunt the government.

The 2003 SARS epidemic is a case in point. According to Indian journalist P. Sainath, who has reported extensively on health issues in Asia, the virus got out of hand because without clinics there was no early warning system that a health crisis was building. While closing the clinics saved hundreds of millions of dollars, in the end, SARS cost China several billion in damages to the economy and tourism.

According to a study by Asian Economic Outlook, the SARS crisis eventually cost Asian and Southeast Asian countries almost \$60 billion.

The rebuilding of clinics will also make a difference in dealing with China's aging population. There are already 134 million Chinese over the age of 60, and by 2050 they will represent one quarter of the country. Not only did many of these seniors see their meager pensions vanish as state-run enterprises went bankrupt, many employers and schools stopped delivering healthcare.

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This system for financing healthcare encourages doctors and hospitals to prescribe drugs, whether they are needed or not. A World Bank study found that in the case of village clinics, less than 1% of the drugs prescribed were appropriate.

In an effort to get a handle on the problem, the government first took a free market approach and raised prices. This, it figured, would make patients

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more cautious about buying drugs. But since patients had no way of knowing whether drugs were needed or not, they relied on the advice of doctors and clinics. In the end, high drug prices only meant that patients paid a much larger part of their income for medicines.

Recognizing that the “market” approach was simply impoverishing people, the government backed off and cut the prices of over 400 drugs by up to 40% last fall.

Starting with rebuilding clinics in the cities makes a certain sense, given the pollution problems that most urban dwellers face. Officials estimate that over 400,000 people die prematurely from respiratory ailments, most of them in the cities, and that pollution levels could quadruple in the next 15 years.

But rural healthcare is also in crisis, in part because rural dwellers are poorer and thus more likely to consider healthcare a luxury, and partly because “rural” does not mean “pristine.” One survey in eastern Jiangsu Province found mercury, lead, and cadmium present in 41% of the local fish. All three heavy metals are associated with birth defects, child development problems, and cancer.

Because urban land is at such a premium—Shanghai real estate prices have climbed 74% in the last four years—many of China’s industries, including coal-fired power plants and cement factories, are located in the countryside. The former produce substantial amounts of sulfur dioxide, a compound associated with asthma and a variety of lung ailments. The latter generate dioxin and furon, among the most carcinogenetic compounds on the planet.

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are judged by how much growth they can deliver, it is not clear anyone will pay much attention to decrees.

The only formal “targets” in the new five-year plan are to double the gross domestic product by 2010 and to reduce energy consumption. Improving the environment is mentioned, but the central theme of the plan, according to the National Development and Reform Commission, is to “give greater play to market forces.”

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There is a division in the Chinese leadership between gung ho free marketers and a growing sector which is clearly worried about the damage China’s run-away economy is inflicting on its environment and people. While the split is portrayed in the West as “conservative old guard” vs. “reformers,” that characterization has more to do with the Cold War than the reality in China today.

The steps on healthcare, fees, and taxes, modest though they are, suggest that the leadership is trying to get a handle on the problems.

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Several provinces are also responding to the unrest by raising the minimum wage. Shenzhen, which accounts for one third of China's exports, is planning to raise wages by 23%, and other provinces are considering similar upgrades. As government lawyer Yang Yiping told the *Financial Times*, "We can't rely on cheap labor alone to attract investment. Workers won't tolerate low wages."

At least not forever.

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Published by Foreign Policy In Focus (FPiF), a joint project of the International Relations Center (IRC, online at [www.irc-online.org](http://www.irc-online.org)) and the Institute for Policy Studies (IPS, online at [www.ips-dc.org](http://www.ips-dc.org)). ©Creative Commons - some rights reserved.

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Recommended citation:

Conn Hallinan, "China: A Troubled Dragon" (Silver City, NM and Washington, DC: Foreign Policy In Focus, May 11, 2006).

Web location:

<http://www.fpif.org/fpifxt/3264>

Production Information:

Writer: Conn Hallinan

Editor: John Gershman, IRC

Layout: Chellee Chase-Saiz, IRC

**p. 4**

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