

KEY POINTS

- Mainstream analysis on China tends to be overly optimistic, leaving a blind spot in strategic planning. While the country's socio-economic landscape has been transformed over several decades of uninterrupted growth, it faces significant domestic and international risks and constraints. Chief among these are labour insecurity and imbalances, environmental constraints and rising climatic risks, and food insecurity, all coupled with rising popular expectations for a higher overall standard of living.
- Major soy producers (Argentina, Brazil and the United States) should take steps to ensure the stability of China's supply. In particular, these countries should set aside reserves to help mitigate future supply shocks and price spikes resulting from climate change.
- Manufacturers operating in or with China should immediately begin mapping their supply chains to identify vulnerabilities associated with crisis scenarios in the country. Where specific risks are identified, they should explore supply-chain diversification to boost resilience among major trading partners.
- To deter China from externalizing internal stresses, international actors should raise the political costs of nationalistic unilateralism by opening more channels for dialogue, deepening institutional integration and buttressing cooperative security norms.

HEDGING AGAINST AN UNSTABLE CHINA: MEASURES TO ENHANCE REGIONAL AND GLOBAL RESILIENCE

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INTRODUCTION: CAUTIOUS APPROACH TO CHINA NEEDED

Historically, few people predicted that China would become a major power as quickly as it has. Its miraculous growth, now taken for granted, caught many analysts off guard. To some, China's continued rise is a source of concern. To others, it is a precondition for prosperity. What happens if China takes a sudden turn for the worse?

The international community has rightly paid attention to the threat of collapse in North Korea, which has teetered on the edge of economic and humanitarian catastrophe for years. Its unpredictable, nuclear-armed totalitarian regime poses an obvious threat to the region. Economic or political upheaval in China would be far more dangerous, and yet far less attention has been paid to these risks. Unlikely though it may be, we cannot afford to be as surprised by Chinese failure as we were by Chinese success. China is a major military and nuclear power, a massive consumer of global commodities, and the manufacturing centre of the global economy. Economic or political upheaval in China would cascade through global systems, with dire consequences for the world's governments and businesses.

Much of mainstream commentary on China has been optimistic. Many analysts project China's unbounded growth into the future as heralding

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the rise of a consumptive middle class (Evans-Pritchard, 2012; Organisation for Economic Co-operation and Development [OECD], 2012). Where China's complex challenges are recognized, it is often assumed that the ruling Chinese Communist Party (CCP) will be capable of surmounting them. A strong, stable trajectory for China is largely taken for granted. Where debate exists, it tends to focus on whether China will be a partner or a challenger for the international system (Legro, 2007: 515-534).

China faces a complex web of economic, social, political and environmental challenges that threaten steady growth and the political stability required by it (see Figures 1 and 2). This policy brief makes the case for planning and implementing contingency measures that would enhance the resilience of vulnerable countries and systems. Prudent policy making with respect to China requires that we hope for the best, while preparing for the worst.

CHINA'S SOCIO-ECONOMIC CHALLENGES

Several decades of mostly uninterrupted double-digit growth rates have transformed China's economy, its society and popular expectations. The CCP's legitimacy today depends heavily upon its ability to provide high levels of economic growth to meet the rising aspirations and material appetites of its citizens (Legro, 2007); however, its capacity to do so is increasingly uncertain. China's complex stresses threaten the country's stability and growth potential. In particular, unemployment, food insecurity and frustrated ambitions risk converging in Chinese cities to produce political and social instability.

China's economy faces both domestic and international challenges and constraints. The country remains heavily export dependent and vulnerable to external shocks.

Figure 1

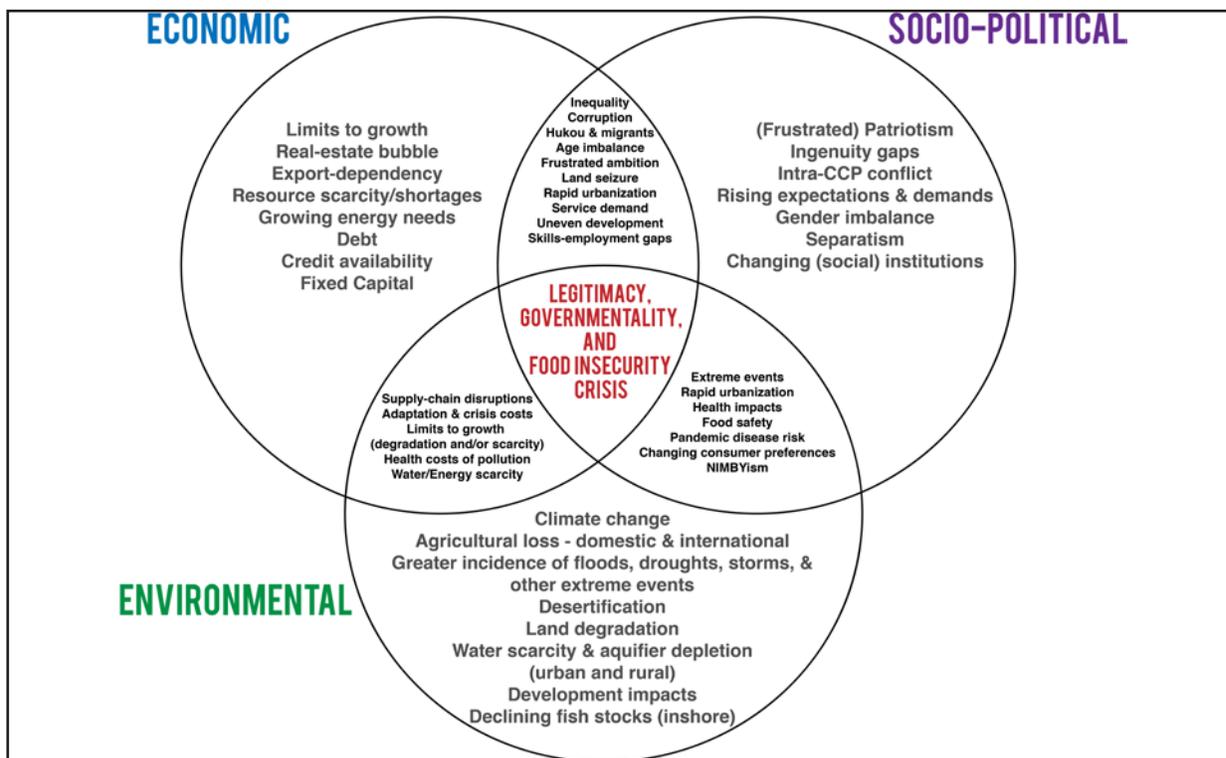
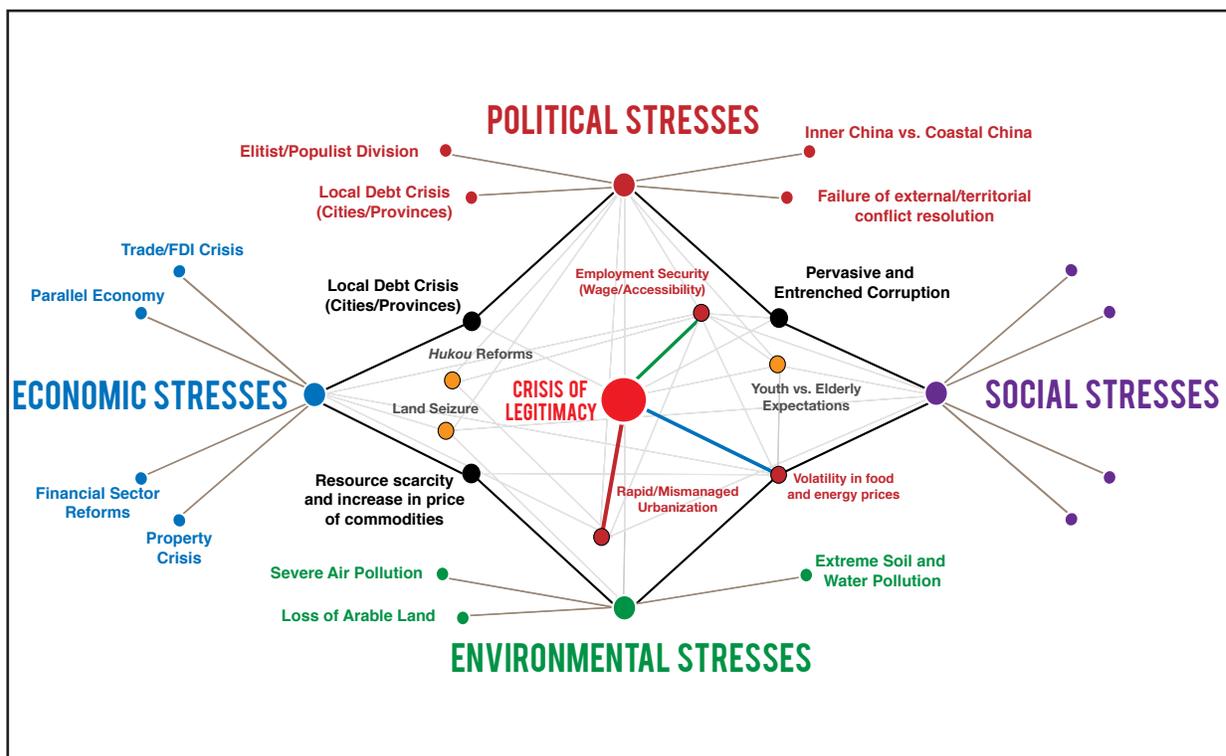


Figure 2



Source: authors.

Growing the economy will require massive increases in China's energy supply, which will be constrained by water scarcity and severe climatic stress (Chan, Knight and Robins, 2012). The country is struggling to provide employment for a new generation of university graduates (Davis, 2013), even as major low-skill manufacturers struggle with rising costs ("Manufacturing: The End," 2012) and labour shortages ("Students by Millions," 2013). Government expenditures will rise with a rapidly aging population and growing expectations for a robust social safety net (Frazier, 2013). Yet local governments are dangerously indebted (Rabinovitch, 2013), and massive government stimulus programs have stifled innovation and contributed to an enormous property bubble ("China Property Prices Climb," 2013). China is plagued by corruption, growing inequality and new class cleavages (Cai and Chan, 2009; Yew, 2010). To date, growth has come at significant environmental and social costs, which citizens are increasingly unwilling to bear. Protests and spontaneous expressions of rage are on the rise (Göbel and Ong, 2012), which the regime seems willing to channel through its foreign policy in an attempt to externalize its domestic pressures.

During the 2008 global economic crisis, China experienced mass unemployment that prompted labour disputes and large protests in major manufacturing centers (Cai and Chan, 2009). Labour disputes have risen from approximately 169,000 in 1999 to 500,000 in 2007; in 2008 the number of labour disputes reached a record high of 931,000 (Cai and Wang, 2012). The regime has since stopped publishing these numbers. A renewed downturn in the Chinese economy, whether from international vulnerabilities or domestic growth constraints, would unleash a new wave of labour insecurity, frustrated ambition and protest, particularly in China's megacities,

which aggregate diverse populations with wide-ranging grievances.

FOOD INSECURITY AND CHINA'S RELIANCE ON GLOBAL FOOD SUPPLY CHAINS

Food insecurity worsens this picture. It is historically strongly associated with crises of legitimacy, unrest and political instability (Arezki and Brückner, 2011; Lagi, Bertrand and Bar-Yam, 2011). China is caught between the need to provide sufficient employment on the one hand, and the need to guard against inflationary pressures and overheating on the other (Roach, 2011; Drysdale, 2011). Both scenarios have direct impact on food security by making key food commodities unaffordable to consumers. Much rides on the ability to increase production ("Chinese gov't confident," 2010); however, even without economic instability, China's food security is uncertain.

China's arable land is already overtaxed and is further threatened by urbanization and desertification (Cui and Kattumuri, 2010; Qi et al., 2005). Among Group of Twenty (G20) countries, China is the third most vulnerable to the effects of climate change (Chan, Knight and Robins, 2011). Some 40 percent of China's grain production is located in the drought-prone north and increasingly severe extreme weather events will threaten China's domestic supply and erode its self-sufficiency (Esterhuyse, 2012).

Of equally great concern is China's growing reliance on global food supply chains, particularly with respect to soybeans. China relies on imports for 73 percent of its soybeans, primarily used for cooking oil and as feed for the pork industry (Schneider, 2011). Pork consumption and soybean imports have soared as a result of growing expectations for a meat-heavy diet. Demand for soybean oil is such that even small price swings have caused riots in local supermarkets ("Carrefour Apologizes," 2007).

The world's three largest producers of soybeans — Argentina, Brazil and the United States — also face serious threats to agricultural capacity and the stability of production as a result of climate change (Food and Agriculture Organization [FAO], 2011). In the United States, some 80 percent of soy production is located in the midwest (Government of the United States, 2013), where extended and worsening drought conditions are reducing and degrading the harvest (Wilson and Dreibus, 2012). Similarly, even under best-case scenarios, in which dramatic action is taken to reduce global greenhouse gas emissions, the amount of land suitable for soy production in Brazil is expected to fall by more than 20 percent over the period 2008–2020 (Wheatley, 2008). In 2008, a drought in Argentina reduced its soy production by a third. But changing rainfall patterns are not the only problem. Increasingly frequent and destructive extreme weather events and commodity speculation drive prices up and increase their volatility.

Critically, these vulnerabilities exist in a context of growing aggregate demand, changing consumer preferences and greater expectations for overall standard of living. With food often purchased daily, consumers are disproportionately sensitive to increases in food prices, relative to other goods (Donovan and Hudson, 2011). Moreover, in lower-income countries and households, food expenditures account for a disproportionate percentage of income, producing even greater vulnerability and sensitivity to food price shocks. In China, urban households spend an average of 36 percent of their income on food, ranging from a low of 28 percent to a high of 47 percent across income groups (Government of Canada, 2010).

A sharp spike in soybean prices combined with rising unemployment and decreased purchasing power would represent a perfect storm. Should the cost of staples rise

to the point that increasingly entitled consumers could no longer afford them, China's cities would become hotbeds of unrest.

ANTICIPATING DISRUPTIONS

Because the CCP's legitimacy depends upon its capacity to deliver economically, and because of widespread inequality and official corruption, the regime would be the direct target of price- or shortage-driven domestic unrest. China's leaders would face urgent calls for redress and reform, neither of which it could easily deliver. If it sought to respond by out-bidding other buyers during a global supply crisis, other states could face sudden explosions of unrest within their own borders. If it failed to respond effectively at all, it might be tempted to play the nationalism card to redirect unrest toward countries with whom China has emotionally charged maritime and territorial disputes, and/or unresolved historical grievances. China's neighbours are already wary of its maritime and territorial ambitions, its rising military capability, its role as a source of infectious disease, and externalities associated with high levels of pollution and environmental degradation. Even a modest move toward externalizing discontent could rapidly escalate into a major international confrontation.

All stakeholders — governments, corporations and international bodies — should be concerned about the threat unrest in China poses to the global economy, regional security and (not least) the Chinese people. It is not too early to prepare for the worst, even as we hope for the best.

RECOMMENDATIONS

Major agricultural producers should be prepared to respond quickly and effectively to a food security crisis in China.

- Argentina, Brazil and the United States should collaborate with Chinese authorities and the FAO to establish early warning systems to reliably monitor, evaluate and forecast agricultural production and food market prices. Particular attention should be paid to the effects of climate shocks and commodity speculation.
- With the certainty of future supply disruptions from extreme weather events, major suppliers and partner organizations should commit to establishing significant regional and international grain reserves to ensure the stability and resilience of supplies and markets. Policy makers should leverage recent climatic and market crises to overcome political opposition to such programs. The G20 could take the lead, but in the particular case of soy an ad hoc minilateral approach involving Argentina, Brazil and the United States would likely be adequate.

Stakeholders — including major trading partners, firms and sector-specific industry associations — should undertake detailed global supply chain mapping and risk analysis to identify vulnerabilities associated with downturn and unrest in China’s urban areas. Where possible and appropriate, corporations should consider supplier diversification.

- Governments and firms with investments and production heavily concentrated in China should engage in dialogue about supply chain mapping and the risks associated with potential unrest or crisis scenarios.

- Sector-specific industry associations and umbrella groups such as the International Chamber of Commerce should be involved in multi-stakeholder dialogue.
- The “China plus one” strategy, whereby firms manage risk by manufacturing in China and another Asian country, should be expanded to a “China plus” strategy by expanding production to several locations, such as Myanmar, Thailand, Vietnam and other Asia-Pacific countries. Planning to diversify supply chains in cases of possible disruption or internal crises should begin immediately.

International partners should secure channels of communication, maintain international platforms of cooperation and construct greater economic partnerships with China to increase the political and economic costs of any attempt to externalize unrest.

- In the event of worsening relations with China, foreign governments should ensure that direct lines of communication (such as hot lines and diplomatic channels) remain open with Beijing to preserve opportunities for dialogue, negotiation and mutual understanding.
- China’s neighbours should seek opportunities to deepen China’s engagement on multiple fronts (for example, culture, education, science, economics, security, law enforcement) to moderate Beijing’s willingness to risk alienating international partners.
- China should be invited to participate in the Trans-Pacific Partnership negotiations.

CONCLUSION

The recommendations in this brief are low-cost and achievable solutions that will help promote resilience

to plausible and high-cost risks associated with China's economic and social instability. The inherent uncertainty of the future and prudent policy making force us to question comfortable assumptions. This brief calls attention to the need for a cautious approach from policy makers and business leaders when dealing with or within China. The complex interdependence between global commodity and food supply chains on the one hand, and social, ecological and political systems on the other, leaves everyone vulnerable to disruptions in the "business-as-usual" narrative. There are many reasons to doubt China's future growth and stability, and neither governments nor businesses can afford to be caught off guard.

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