

UNDER THE RADAR

China's Soft Underbelly

Why age, skilled labor and polluted water threaten the country's economy and political stability

BY STEVEN BESCHLOSS

FOR THREE MONTHS, 26-year-old Fan Meng pushed his wheelchair-bound mother nearly 3,500 kilometers from Beijing to Xishuangbanna in Yunnan province to fulfill her long-held dream of visiting the idyllic travel destination. This epic journey, widely covered last year by the Chinese media, is an inspiring tale that harked back six centuries to the beloved folk classic, the *24 Paragons of Filial Piety*. Among its fables: The son who strangles a tiger to save his father and the 8-year-old who lets a swarm of mosquitoes bite him to protect his parents.

These days, in an increasingly urbanized China where grown children often live great distances from their elderly parents, such tales spur debate about the changing dynamic in modern Chinese families. They offer an

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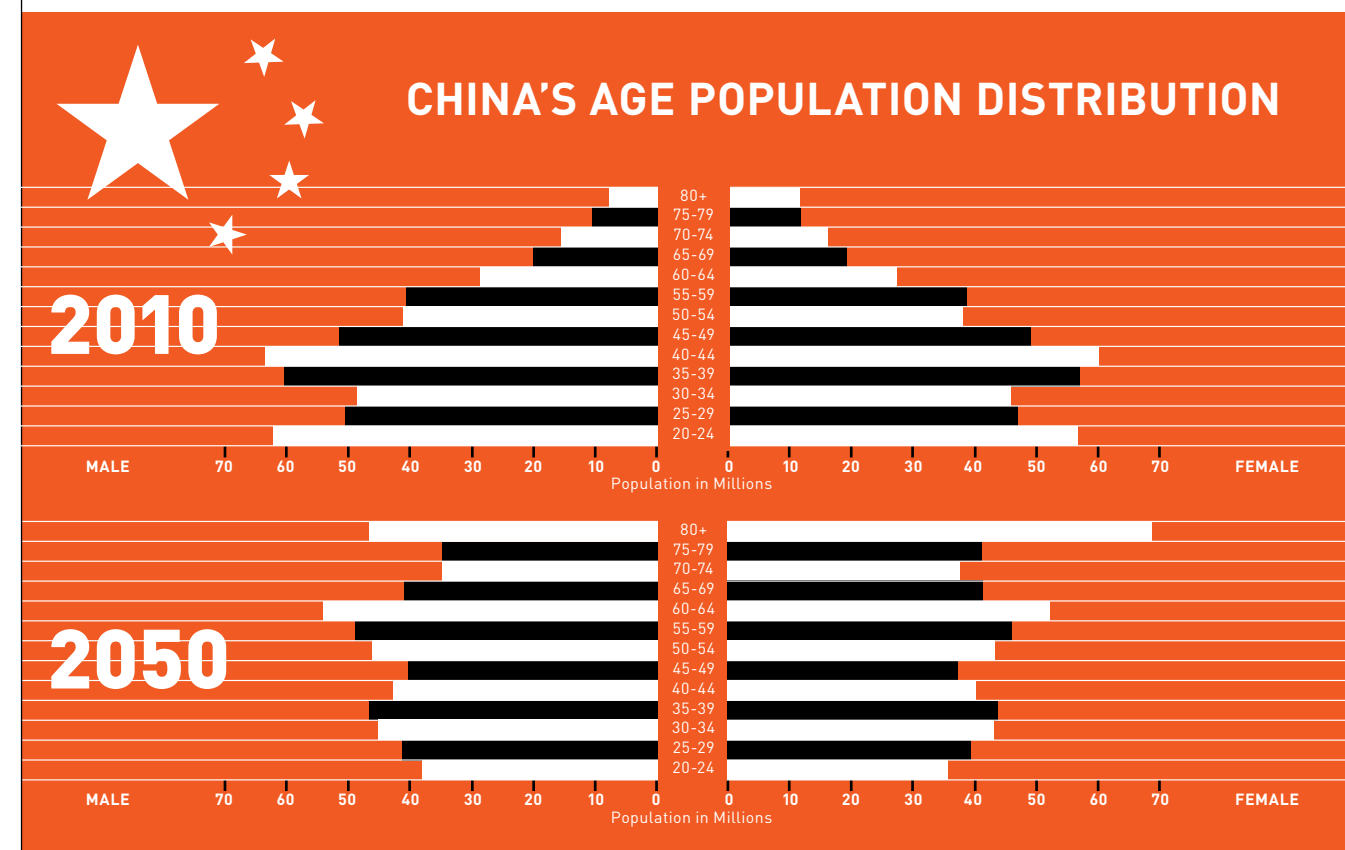
uneasy reminder of the widening generation gap—and the treacherous gulf between the Communist Party's 2006 resolution to create a "harmonious society" by 2020 and the far more complicated on-the-ground reality.

When nearly 3,000 Chinese age 20 and older were asked who should provide for the elderly, their answers illuminated the bumpy road ahead: Only 4% thought it was the responsibility of the grown children or other family members. Another 9% believed it was up to the retirees themselves, while a whopping 63% thought the burden should rest with the government.

These numbers, more extreme than every other Southeast Asia country surveyed, were not simply an intriguing snapshot of rapid modernization and shifting Confucian ethics. As the Center for Strategic & International Studies (CSIS) documented in its 2012 report "Balancing Tradition and Modernity: The Future of Retirement in East Asia," China faces a burgeoning national crisis with global implications as it confronts a swiftly aging population. This demographic shift—from one of the world's youngest populations to one of its oldest—represents one of a series of challenges that raise serious questions about China's ability to sustain rapid economic growth and maintain social and political stability.

Yet while China is still on target to become the world's largest economy during this decade, the combination of an aging population, a significant shortage of skilled workers and managers, and a shrinking supply of usable water has the potential to destabilize leadership that has built its legitimacy on the twin pillars of rapid growth and social stability.

"All of these issues are touching people's daily lives and taking a toll on the economy," says Michal Meidan,



Source: U.S. Census Bureau, International Data Base

China analyst for the Eurasia Group, a political risk research firm in London. "The business-as-usual scenario in China is not feasible and not sustainable."

It's not as if either the Chinese leadership or global decision-makers have missed the potential risks. The realities of an aging population and looming water crisis (see "Water Wars and Opportunities" on page 24) were among the top five global threats in the recent report of the World Economic Forum. In 2007, then-Premier Wen Jiabao acknowledged that China's growth model was already reaching its limits economically, socially and ecologically. At a news conference during the National People's Congress, he called it "unstable, unbalanced, uncoordinated and unsustainable."

In China's five-year plan announced in 2011, each of these issues has drawn attention with fresh policies to

address them. But, as Meidan notes, "the difficulties with policies are in the implementation."

Demographics as Destiny

Richard Jackson, senior fellow at CSIS and director of its Global Aging Initiative, calls China's aging population a "stunning demographic transformation." After three decades of a record share of working-age people 20 to 64, China is about to face a decline among its working-age population and a rise of elderly—from 8% in 2010 to 16% in 2030, and 24% by 2050. According to United Nations data, there were 7.8 working-age adults to support every elder in 2010, falling to 3.8 in 2030 and only 2.4 by 2050. By these estimates, within 25 years China will have an older population than the United States.

This elderly boom comes at a time when China has not adequately focused on providing public pensions, health care and other social protections. Jackson estimates that public pensions, which now represent 3% of GDP, would cost at least 10% of GDP by 2030 with the same average benefits of today. (While the basic pension varies widely in different parts of the country, in some rural counties it can be as low as 55 yuan, or about \$8.85 per month.) This will place new fiscal burdens on public budgets and increase pressure for higher tax rates—both of which will play a role in decelerating economic growth.

“The government is scrambling to extend pensions to migrants,” Jackson says. “But, I think it’s too little—and it needs to devote more resources to them.” If the high expectation of government support to cushion the growing elderly population is not met, “it portends a social or even political crisis.”

Since the one-child policy was put in place by Mao successor Deng Xiaoping in 1979, China has seen its fertility rate (the number of births per woman) drop from 4.8 in the early 1970s to 1.8 by the mid-1990s. That low fertility rate, which remains today, coincided with China’s economic reforms, huge gains in economic growth and urbanization, and expanding life expectancy.

Although there is no way around the near-term surge in old-on-young dependency, lifting the unpopular one-child policy represents one possible solution to China’s long-term dilemma. Jackson says raising the birth rate to 1.9 or even 2.0 “would be very helpful” in providing an expanded working-age population several decades from now. Still, while one Chinese government think tank backed a nationwide two-child policy by 2015, and dropping all birth limits by 2020, the Chinese leadership has remained opposed. “It’s hard to adjust to the new reality,” Jackson says.

Finding Talent in a Country of 1.4 Billion

It may seem hard to believe that in a country of some 1.4 billion people there could be labor shortages. But the expansion of value-added, skill-intensive manufacturing and growing service sectors have begun to lay bare the skills and education gaps China is facing. Based on data from China’s National Bureau of Statistics, the McKinsey Global Institute recently estimated that China will be

short some 23 million high-skilled workers by 2020, when an estimated 140 million jobs will need to be filled.

This 16% shortfall of college-educated workers—exacerbated by the one-child policy—is unlikely to be closed, despite massive investments in education and an estimated 50 million additional college graduates by 2020. Currently, only 11% of the Chinese workforce holds a college degree. This reality adds to China’s challenge of sustaining its growth trajectory, lessening its competitive advantage by driving up salaries and heightening doubts among international companies that depend on China-based operations.

“This skills shortage is the real bottleneck in China,” notes China business analyst Francesco Sisci, based in Beijing since the 1980s. “This lack of skilled workers is going to take a while to sort out, and they have been reluctant to hire foreigners.”

A Real Bottleneck

While foreign multinational companies may rely on foreigners to fill their senior ranks—typically at a hefty premium—many of the Chinese-owned firms have been reluctant to follow suit, preferring management skilled in Mandarin and knowledgeable about Chinese culture and mores.

As a result, a rising tide of Chinese-born and foreign-educated talent, known as “sea turtles,” have been flowing back. (The Chinese Ministry of Education cited 135,000 in 2010.) They are taking advantage of higher salaries (up an estimated 15% to 20% in the last year), a growing demand for their advanced skills, knowledge of Western business practices, and often more opportunities at home in China than abroad these days.

In addition, the Corporate Executive Board, the New York, New York-based business advisory group which has collected data on more than 300,000 employees and job candidates in China since 2006, found that a growing number of Chinese professionals are preferring to work for domestic firms—28% in 2010, up from only 9% in 2007. That trend seems certain to continue: Chinese companies are aggressively recruiting top domestic talent by offering career advancement and appealing to their national pride.

Even though multinational companies can simply pay top dollar for top talent from overseas, the overall gap

is unlikely to be filled by foreigners. “Hiring foreigners is harder because they have to fight against xenophobia,” Sisci explains. Yet as demand intensifies in the years ahead, that cultural paranoia may, by necessity, begin to soften.

A Thirst for Water

Recognition that China is facing a water shortage has been building, even before the World Economic Forum cited a water-supply crisis as one of the top five global risks in terms of likelihood and impact. A year ago, Hu Siyi, vice minister of China’s Ministry of Water Resources, darkly warned that water usage in China had “already surpassed what our natural resources can bear.”

While China’s five-year plan ending in 2015 includes broad directives related to expanding environmental protection, three new water policies announced in January highlight the growing seriousness. These include requiring five provinces to reduce their water usage by 2015, including Shanghai, Jiangsu and Guangdong; implementing new water pricing and caps based on type of water (surface or groundwater), industry (amount of pollution and water usage), local economic growth and scarcity levels; and new market-based solutions with the creation of 50 new environmental companies concerned with recycling, solid waste and other water treatment technologies.

This growing awareness and targeted policies couldn’t come soon enough. As water expert and author Peter Gleick summarized in his book, *The World’s Water*: “China’s water resources are over-allocated, inefficiently used and grossly polluted by human and industrial wastes, to the point that vast stretches of rivers are dead and dying, lakes are cesspools of waste, groundwater aquifers are over-pumped and unsustainably consumed, uncounted species of aquatic life have been driven to extinction, and direct adverse impacts on both human and ecosystem health are widespread and growing.” Gleick notes this means that 300 million people—nearly one-quarter of the population in China—lack access to safe drinking water.

Debra Tan, director of China Water Risk, a nonprofit information resource group based in Hong Kong, says that agriculture and industry account for 85% of water usage, and that even the bigger international companies have generally not been engaged in pursuing improvements. According to a 2012 Klynveld Peat Marwick Goerdeler

(KPMG) study on water scarcity and global reporting trends, only 7% of the 100 largest companies in China reported a long-term water strategy. “I think industry is just beginning to realize the problem because these caps and fees were not there before,” Tan says.

But Tan sees corporate and political engagement beginning to grow. “The government actually understands the problem,” she says. “If anyone can solve this, China can.”

Finally, a Matter of Politics

However, transforming that knowledge into meaningful reforms takes time, especially in a country as large and bureaucratic as China. And some China experts see growing public unrest in the country as a real threat to party control. Michael Colopy, an analyst and consultant with extensive China connections, told an MSCI conference in February that “the Chinese leadership is fearful of the building public anger over corruption, censorship and increasing environmental degradation in the country. We know of some 180,000 instances of public protest in the last year alone.”

Meidan of the Eurasia Group anticipates it will be several years before the new Chinese leadership is ready to pursue reform. Much of the attention will focus on the newly installed President Xi Jinping and Premier Li Keqiang. “It’s going to be two to three years of muddling through as they consolidate power,” he says.

Make no mistake: the pressure is rising—for political accountability and action that acknowledges the diversity of long-term needs. “The party’s legitimacy solely on the basis of economic growth is eroding,” Meidan says. But, pursuing a new path will require navigating an uneasy balance. “When do you stop relying on high growth rates?” Meidan asks. “When do you bite the bullet and make painful choices?”

The answers to those questions will surely decide whether China moves closer to its stated goal of becoming a harmonious society, or one that becomes more tumultuous and brittle. 📌

Steven Beschloss is an award-winning editor, journalist and filmmaker. His work has been published in the New York Times, New Republic, Chicago Tribune, Village Voice, Wall Street Journal and Parade Magazine.