



CSBA

Center for Strategic and Budgetary Assessments

# WHICH WAY THE DRAGON? SHARPENING ALLIED PERCEPTIONS OF CHINA'S STRATEGIC TRAJECTORY

ROSS BABBAGE

WITH PAPERS CONTRIBUTED BY:

JACK BIANCHI

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## **ABOUT THE CENTER FOR STRATEGIC AND BUDGETARY ASSESSMENTS (CSBA)**

The Center for Strategic and Budgetary Assessments is an independent, nonpartisan policy research institute established to promote innovative thinking and debate about national security strategy and investment options. CSBA's analysis focuses on key questions related to existing and emerging threats to U.S. national security, and its goal is to enable policymakers to make informed decisions on matters of strategy, security policy, and resource allocation.

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## ACKNOWLEDGMENTS

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This project has required a sustained team effort. A high-level closed workshop was held in Washington D.C. and two in Canberra. Senior researchers and others participated in all three and were generous in contributing both their time and their thoughts. Jack Bianchi undertook a quality literature review that addresses the poor track record of attempting to predict the future using standard methodologies. This contribution is at Appendix A.

The backbone of this report is a set of four major papers that address the alternative futures for China in key domain areas. Aaron Friedberg and Nadège Rolland address the primary scenarios for China's political leadership and political system. They also contributed a second chapter dealing with the primary geo-economic and geo-strategic scenarios for China in 2035. Julian Snelder discusses in considerable depth the alternative futures for China's economy in 2035. Toshi Yoshihara assesses the primary military scenarios for China. These contributing authors made very major and sustained contributions to this project. Their research papers are at Appendices C, D, E and F.

An early draft of the complete report was circulated for comment to all contributing authors, three senior Australians and four senior Americans. Valuable insights were contributed at all phases of this project for which the author is deeply grateful.

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# Executive Summary

This report argues that China's future trajectory and that of the broader Indo-Pacific region are inherently unstable. There is a strong possibility, maybe a probability, of major changes in the strategic landscape by 2035. In the face of these great uncertainties, the strategic assessment and capability development systems the United States and its allies have inherited from the twentieth century are inadequate.

The rapid pace of change in the Indo-Pacific is bringing significant developments almost every month and sometimes more often. In the health area alone, 2019 saw China struggling to deal with a massive outbreak of swine flu fever. In 2020 the coronavirus brought most of the country to a halt. The prospects of further natural disasters, economic disruptions, military reverses and significant political shifts cannot be ruled out but the specifics are also impossible to predict. In this fast-moving environment, expert reviews published every few years as national defense strategies, defense white papers and national defense guidelines are rarely useful in providing more than short-term insights. Their track records in attempting to predict developments 15–30 years into the future have been patchy at best and they have provided an inadequate basis for medium and longer-term defense and security decisions. Given the dynamism of the Indo-Pacific, and especially the unpredictability of China's trajectory, there are strong incentives for considering alternative strategic assessment approaches. A better planning methodology is needed.

One attractive approach for defense and security planning in the Indo-Pacific is to draw on the best expertise in the field to carefully craft a small number of scenarios (say 3 or 4) that, as a set, are representative of the credible future space in the region in 2035. Once the key features of each alternative future are described, it is possible to list the streams of lead indicators that would be observed on the pathways to each scenario 15 years hence. Using these tracks of lead indicators as signposts, intelligence agencies can plot actual events as they occur so as to provide early guidance on which scenario, or combination of scenarios, looks likely to become the shape of the future. It should also provide a firmer basis for confident defense planning and capability acquisition decisions in early timeframes.

There is another advantage of developing a small number of representative scenarios for 2035 from the outset. These clear alternative futures can be used immediately by planners to design, develop and test tailored strategies, operational concepts and mixes of military and security systems that are optimized for each scenario. Hence, if the pattern of actual events “lights up” the lead indicators towards a particular scenario, optimal mixes of strategy, operational concepts and systems will already have been determined and government leaders can be briefed to take appropriate decisions promptly.

At the core of these allied defense and security decision-making processes for the Indo-Pacific is the need for a deeper understanding of China’s future trajectory. This report addresses these issues by including papers prepared by leading experts that examine the primary drivers of China’s future in the political, economic, military, and geo-political and geo-economic domains. A key conclusion of these expert contributions is that the geographic and demographic features of China 15–20 years hence are relatively easy to discern. However, many other factors are much more dynamic and could shift in multiple directions in the period ahead. These important but very uncertain variables include:

1. The power, performance, and durability of the Chinese Communist Party regime.
2. The economic, technological, and corporate progress of the country.
3. The extent to which the regime employs the country’s modernized military aggressively beyond China’s borders.
4. The level of international cooperation or resistance that confronts China.
5. Whether the Chinese regime will seek to rally the country by adopting highly nationalistic rhetoric and international stances.
6. The extent to which the Chinese regime moves to expand its international political, economic and military footprint in key parts of the Indo-Pacific region and beyond.

This report assembles credible combinations of these ‘driving forces’ to derive four alternative futures for China—and effectively for the region—in 2035. The four chosen scenarios are:

1. Xi Jinping’s Dream—a future where just about everything goes well for Xi Jinping and the Chinese Communist Party.
2. Muddling Through—a future where the Chinese regime encounters a series of economic, international and political disappointments but, despite diminished credibility at home and abroad, survives into the late 2030s.
3. Nationalist Drive—a future where serious economic, social, international, and political difficulties cause sporadic outbursts of political dissent. A succession of domestic crises highlights the inadequacies of the party leadership and triggers the replacement of Xi

Jinping and most of the current party hierarchy by a nationalist regime with an assertive international stance.

4. Macro-Singapore—a future where economic, social and political difficulties mount but Xi Jinping moves decisively to alter the country's direction. He institutes far-reaching economic and social reforms, reduces the country's military and international footprint, and negotiates a genuinely cooperative partnership with the West.

This report argues that these four scenarios, as a set, represent the credible scenario space for China in 2035. It does not suggest that these scenarios are the most likely alternative futures. But, as a group, they provide a valuable framework for developing and tracking lead indicators so as to produce early guidance on the real shape of the future and a chance to make timely decisions on acquiring the strategies, operational concepts and the military and security systems that will be most appropriate.

The end result should markedly reduce the uncertainties about the strategic environment in the 2035 timeframe and provide greatly improved foundations for confident decisions on security policy and capability development. In short, this approach offers a superior way of addressing the security challenges faced by the Western allies and their security partners in the Indo-Pacific.

The primary conclusions of this report are:

1. China's current strategic situation is characterized by multiple instabilities and uncertainties. While it is possible that China will continue on its current trajectory towards 2035, it is more likely that there will be significant departures. The United States and its close allies need to be prepared for major changes and to have thought through how best to manage such situations well in advance.
2. The assumption made by many in the West that the rapid rate of economic growth that China has experienced during the last three decades will be maintained during the 2020s is possible but very unlikely. China's rate of GDP growth has already halved since 2007 and continues to slow. Productivity levels are also falling along with international competitiveness in many sectors. National debt is very high and the budgetary burdens of a rapidly aging population are increasing. In the face of these challenges, as well as biosecurity and other pressures, Xi Jinping's instinct is to clamp down harder on information flows, further tighten party control, increase the centralization of power and work hard to maintain a sense of normality. Important consequences of this approach are to further constrain economic dynamism and increase the unpredictability of China's trajectory to 2035.
3. The defense of Taiwan and the integrity of the U.S. and allied positions on the first island chain in the Western Pacific will continue to be inseparable and mutually reinforcing. Measures to harden the frontline states, including Japan, Taiwan, and the

Philippines will not only complicate the PLA's campaigns plans, but also compel Beijing to stay fixated on local contingencies at the expense of its extra-regional ambitions.

4. The actions or inactions of the United States and its allies will have a substantial influence on the Chinese regime's behavior during coming decades, particularly China's actions beyond its borders. There are strong incentives for the Western allies and their partners to consult more extensively on the challenges posed by the Chinese Communist regime and the most appropriate strategies and operational plans.
5. The habit of the Western allies of basing their defense planning and priorities on periodic strategic reviews which are maintained as guideposts for several years is inadequate for the dynamic situation in the Indo-Pacific. Confident security and defense planning require a different approach.
6. The Western allies need a planning system that can accommodate marked changes in China's trajectory. The need is for a mechanism that can detect and assess strategic changes in China promptly and link them directly to rapidly-paced Western counter-measures. Devising and implementing such an alert and agile system is a primary 'front-end' challenge for allied defense and security planning.
7. By defining a set of representative scenarios, a firm foundation can be provided for making logical capability choices in a progressive manner through the fifteen years of a defense planning window. The scenarios and the accompanying lead indicator and monitoring systems should ensure that initial defense capability decisions are well-matched to China's trajectory. At an early stage in the process officials can analyze in some depth the most important capabilities and operational concepts that should be put in place if China looks to be heading for a particular scenario outcome in 2035.
8. The type of scenario-driven planning and capability development methodology described in this report is not intended to be a set and forget approach. A process of this type should be adequate to guide priorities for defense investment for the first three to five years and should then be repeated.
9. There would be value in using competitive analytical processes to identify one or more strategic or operational concepts that could change the game in the Indo-Pacific in the same way that the assault breaker and the follow-on forces attack concepts changed the deterrence and defensive balance in Europe in the 1980s. Innovative possibilities such as these deserve special attention because if experiments and tests verify that they would be effective, they may become strong drivers of the choices for development and acquisition across all credible scenarios.
10. Almost all credible futures for China pose challenges for the United States and its allies that are multi-disciplinary. Effective Western actions to influence, coerce, or counter Beijing will require coordinated actions across government, across nations, and, in many cases, across the broader Western alliance. Activating, energizing, directing, and

coordinating such complex operations will be a major challenge for all parties, especially for the United States and its close allies. It will, however, be essential for success. Current mechanisms for consultation, coordinated planning, and combined action may be suboptimal for the current situation and warrant careful review.

11. If the United States and its close Indo-Pacific allies closely coordinate their planning and operations they have the potential to actively shape the future and, in many situations, strongly influence Beijing's decision-making and medium- and longer-term trajectory. Options for shaping and channeling Beijing's behavior deserve far greater research and policy attention.
12. One of the biggest constraints on achieving success in these and related reforms may be the difficulties in adapting personnel cultures, bureaucratic systems and staff skill sets. These issues will need to be accorded high priority. Revised personnel, management, and operational systems will need to be developed and implemented in close partnership with the modernized systems for selecting, designing, testing, and manufacturing new hardware and software. Exceptional leadership will be required.

The primary recommendations in this report are:

1. The Western allies should give greater consideration to the prospect that China will depart from its current trajectory in coming years. The potential implications of these anticipated shifts in one or more domains could have profound strategic consequences. The allies should strive to develop a deeper understanding of potential changes and consider those they wish to encourage and those they wish to thwart.
2. In order to deal with the multi-disciplinary challenges that are likely to be posed by the Chinese regime in coming decades, the Western allies and their security partners should critically review their current systems for strategic assessment, developing strategy and for planning and managing rapidly-paced operations across multiple agencies and non-government entities.
3. Allied defense and security organizations should avoid the use of single-scenario analyses when considering major defense investments for future operations in the Indo-Pacific theater.
4. Allied defense organizations should trial a process of scenario development and continuous lead indicator tracking. This should provide clear guidance on the region's security trajectory, permit early consideration of alternative strategy, operational concept, and capability mixes and facilitate timely decision-making.
5. The United States and its allies should use small competitive teams to sharpen the quality and timeliness of some strategic assessment and capability development processes.

6. The Western allies and their partners should consult more extensively on the challenges posed by the Chinese Communist regime and the most appropriate strategies and operational plans to deter and, if necessary, confront Beijing. Current mechanisms for consultation, coordinated planning, and combined action may suboptimal for the current situation and warrant careful review.
7. In working to institute such reforms, an early priority should be a substantial strengthening of personnel cultures, organizational systems and multi-disciplinary skill-sets. Exceptional leadership will be needed.
8. There would be value in using competitive analytical processes to identify one or more strategic or operational concepts that could ‘change the game’ in the Indo-Pacific in the same way that the assault breaker and follow-on forces attack concepts changed the deterrence and defensive balance in Europe in the 1980s.<sup>1</sup> Innovative possibilities such as these deserve special attention.
9. The United States and its allies should consider the potential impact of the reforms proposed in this report to strengthen Western resilience and endurance, particularly in the event of an extended period of tension or conflict.

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<sup>1</sup> For an explanation of the history of ‘Offset Strategies’ such as Assault Breaker see: Robert O. Work and Greg Grant, *Beating the Americans at their Own Game: An Offset Strategy with Chinese Characteristics* (Washington, DC: Center for New American Security, 2019), pp. 2-3.



## CHAPTER 1

# Planning with Confidence in the Face of Uncertainty

Allied defense and security planners are confronted by a serious problem in the Indo-Pacific. It is impossible to predict most types of development in this region beyond the very short term with any certainty. Making strategically useful judgements about China's future is especially challenging because of the vast number of variables and uncertainties involved. While many experts and groups of experts have applied themselves to this task in the post-Mao era, the track record has been poor. This has serious implications for allied policymakers who are required to make decisions today that will shape their countries' choices, capabilities, and outcomes vis-à-vis China for decades to come.

There are many reasons why attempting to predict China's future for any but the short term is fraught.

As Jack Bianchi explains in Appendix A, several forecasting methods can be applied to the rapidly changing China but they all entail forms of "pattern fitting," in which the future is presumed to develop in a certain way according to existing information about the past. Such approaches are undermined by the limits of what we know and what we are capable of knowing. Uncertainty, chance, chaos, and human choice make standard forms of prediction on most issues for more than the short term incredibly difficult.

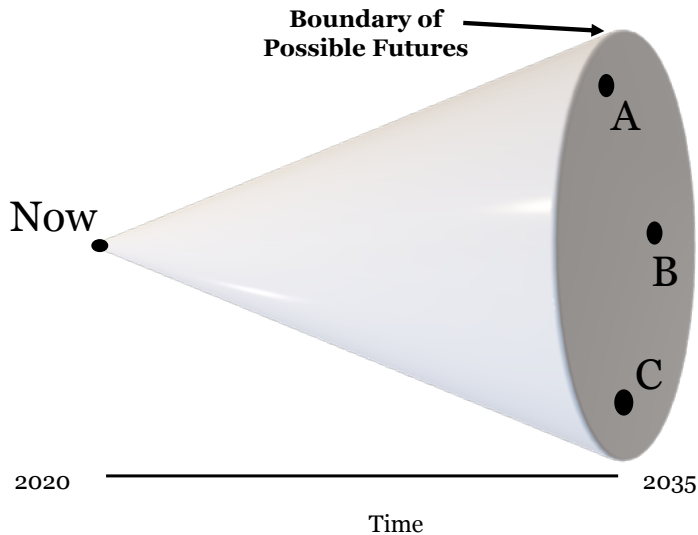
A few predictive methodologies can produce reasonably accurate results in some economic and other areas for six to twelve month periods. In a few fields, such as the demographic outlook, predictions 20–30 years forward can be relatively accurate. Beyond that, it is really only in a few areas—such as tidal flows, astrological movements of planets and stars, and geographic landforms—that accurate predictions decades ahead are feasible.

For defense and national security leaders needing to select strategy and expensive capability options for the long term in the Indo-Pacific, the standard predictive methodologies

are clearly inadequate. Faced with the challenge of clarifying the future for China, some security planners may be inclined to double down on existing methods and processes. There is sometimes a preference to attempt further refinements of familiar approaches or involve new teams of experts in efforts to derive improved results. Other security planners and policy makers may be tempted to commission a detailed assessment of China's future and then leave it set as a guiding beacon for many years. Unfortunately, as Appendix A makes clear, such approaches may be bureaucratically convenient, but they are unlikely to produce robust foundations for future Western security planning in the Indo-Pacific. A different approach is needed.

This report argues that it is better to acknowledge from the outset that there are many possible futures for China in the primary timeframes of relevance. Some credible visions of the future can be defined from the start but exactly which future will come to pass will only become clear as real-life developments are tracked closely through the planning timeframe. This approach is illustrated in Figure 1 below.

**FIGURE 1: DEVELOPMENT OF ALTERNATIVE FUTURES FOR CHINA OVER TIME**

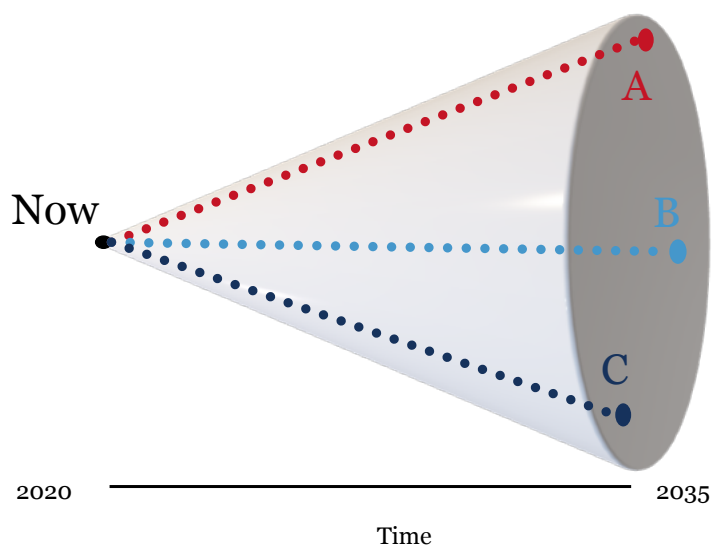


The current situation is depicted at the narrow, left-hand end of the cone. Three to five alternative scenarios are then carefully crafted to represent different futures in 2035. In the simplified model above, three alternative scenarios for China in 2035 are displayed. Scenario A might describe a China that successfully rides through its current problems to arrive at an outcome that achieves all of the core goals of the Chinese Communist Party. Scenario B might describe a future for China that is an uncomfortable mix of successes and failures and Scenario C might represent a future for the Chinese regime which is much bleaker.

The scenarios need to be developed with great care in a process that is described later in this chapter and in Appendix B.<sup>2</sup> Individually, they may not describe the most likely futures for China but, as a set, they are representative of the credible range of possibilities for 2035. When considered together they provide reasonable coverage of the credible scenario space that is displayed as the open cone at the right-hand end of Figure 1.

The best way of planning Western defense and security investments during the initial period on the left is not to make an informed guess about the shape of China in 2035 and then use that prophecy to drive decisions on the key capabilities required for many years. A much better approach is to track the trajectory of developments in China throughout the 15-year time horizon and make incremental changes throughout the period. This would ensure that allied defense and security structures are close to optimal along the way and that they are well suited to deter and counter the type of China that actually emerges in the early 2030s.

**FIGURE 2: LEAD INDICATORS OF ALTERNATIVE FUTURE SCENARIOS**



2 Please note that the methodology described in this report is a slightly modified version of the process described by Peter Schwartz in his path-breaking book: Peter Schwartz, *The Art of the Long View: Paths to Strategic Insight for Yourself and Your Company*, (New York: Crown Business, 1996). In recent years CSBA has undertaken a number of studies involving scenario analyses. They include Evan B. Montgomery, “Defense Planning for the Long Haul: Scenarios, Operational Concepts, and the Future Security Environment” (Washington, DC: Center for Strategic and Budgetary Assessments, 2010); Andrew F. Krepinevich, “The Conflict Environment of 2016: A Scenario-Based Approach” (Washington DC: Center for Strategic and Budgetary Assessments, 1996); and Barry Watts, “The Case for Long-Range Strike: 21st Century Scenarios” (Washington, DC: Center for Strategic and Budgetary Assessments, 2008).

This process is illustrated in a simplified form in Figure 2. On the far left of the figure is the force-in-being that has been inherited from earlier decades. Decisions that need to be made in 2020 aim to optimize capabilities for the immediate and medium-term future and also build in some flexibility to cope with more diverse possibilities in the longer term. The aim would be to adapt, supplement, or replace the initial capabilities during the following 15 years to ensure that no matter which scenario eventuates in 2035, or along the pathway to that year, the allies will be prepared in an optimal manner.

Key to this process is a clear description of each representative scenario and a listing of the events that would need to take place, or most probably would take place, on the pathway to each scenario in 2035. Hence, it is possible that during the course of 2020 and early in 2021 three or four indicator ‘lights’ would illuminate suggesting that China was heading towards Scenario B rather than A or C. Allied investments during that period would then be made that focus primarily on the requirements of Scenario B, though building in some flexibility to adapt quickly were subsequent indicators to veer more towards Scenarios A or C in later years.

In parallel with the identification and listing of the lead indicators on the pathway to each scenario, allied defense and security planners would need to determine the optimal strategies, operational concepts, and capabilities that would be best suited to deter and defend against China in each of the three scenarios. This determination would produce a “shopping list” of strategies, operational concepts, and capabilities that would optimize allied performance in the circumstances of each alternative future. Some requirements will feature on the shopping lists for all scenarios. However, there are also likely to be notable differences between the shopping lists for scenarios A, B, and C. These unique or special requirements need to be highlighted because they will require particular attention as the strategic trajectory of China becomes clearer over time.

At the beginning of the process in 2020 three key tasks would need to be completed. First, through a process of expert analysis three to five scenarios would be carefully crafted that are both credible and representative of the scenario space in 2035. Second, sets of lead indicators would need to be identified and plotted for each scenario across the 15-year time horizon. And third, strategy, operational concept, and capability shopping lists would need to be developed that are optimized for each of the three to five alternative futures.

Once these three foundational elements are in place, informed decisions can be taken on system development during the first one to three years of the rolling program. In this initial phase the primary foci would likely be two-fold. First, reviewing the strategies, operational concepts, and capabilities that have been inherited from earlier decades for their relevance in meeting the China challenge going forward. Second, assessing those strategy, operational concept and capability items that appear on all of the scenario shopping lists. If these common elements are validated by intense gaming, associated analyses and senior leadership judgements, they would become core priorities for defense and security development—especially during the first few years.

Within two to three years several lead indicators could be expected to give a clearer sense for China's trajectory over the medium term—say towards Scenario B. This would provide a basis for starting to give priority to the special strategy, operational concept, and capability requirements that have been identified on the 'shopping list' for that scenario. Early identification of these special requirements should facilitate action to redirect and tune force development in a timely way.

## **Some Benefits of the Scenario-based Methodology**

This process of scenario-based planning has several attractive features.

First, rather than attempting to perform the impossible task of predicting the future for China 15+ years in advance, it manages future uncertainties by tracking the lead indicators of China's trajectory and triggering relevant decisions in a timely manner.

Second, by closely tracking Chinese developments and promptly facilitating responsive decisions this methodology avoids the pitfall of locking in a chosen vision for China's future over a period that is too long to be credible. It maximizes the prospects of the allies taking rational decisions promptly and of being well prepared with suitable capabilities no matter what the future of China turns out to be.

Third, if implemented well, this incremental process of capability development markedly reduces the scope for misplaced investments and wasteful expenditure. It ensures tailored capability development that effectively counters the specific challenges China poses within specified timeframes.

Fourth, the process is rational, logical, and deliberately phased. It would provide a sound basis for periodically briefing political leaderships on the trajectory of China and the strategies, operational concepts, and total force capability sets that are most appropriate. It would make clear to senior decision-makers why particular approaches and capabilities are required and the timeframes in which key decisions need to be taken.

Fifth, although this process would be focused primarily on countering the future security challenges posed by China, it should also generate a range of capabilities that are able to deal with any unexpected or lower priority contingencies that arise during the 15-year development period.

And finally, this process of planning is proven. Rigorous scenario-based planning has been used extensively over the last thirty years to assist numerous corporations and government organizations and even private individuals achieve optimal outcomes when confronted by highly uncertain and very challenging environments.<sup>3</sup> It has great potential to clarify the priorities for allied defense and security investment in the highly dynamic Indo-Pacific.

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3 Ibid.



## CHAPTER 2

# Using Representative Scenarios to Drive Agile Defense Planning

The foundations for the draft assessments made on China's strategic future in this report draw on four expert papers that address the primary domains of relevance. The four expert contributions are:

- *Primary Scenarios for China's Political Leadership and Political System in 2035*, by Aaron Friedberg and Nadège Rolland;
- *China's Economic Futures in 2035*, by Julian Snelder;
- *Scenarios for China's Military in 2035*, by Toshi Yoshihara;
- *Primary Geo-economic and Geo-strategic Scenarios for 2035*, by Aaron Friedberg and Nadège Rolland.

These four papers may be found in Appendixes C, D, E, and F.

Consolidating the logic and conclusions of these four contributions into a single scenario set is relatively easy because although they were written semi-independently, the four papers feature closely related themes. Most notably, each of the four papers highlights a scenario that portrays success for the Chinese Communist Party regime in all domains. A second shared theme envisages a future in which the regime is frustrated by multiple disappointments and national progress is stymied or delayed. A third strong theme in the expert papers is the possibility that the regime might fail to achieve its objectives in multiple fields but will nevertheless muddle through with reduced domestic and international credibility. A fourth possibility is that following a succession of failures the regime chooses a path of political and economic liberalization or, alternatively, is replaced by a military coup. In the latter case, in particular, such a change would probably be accompanied by a strong nationalistic narrative. This report argues that these primary themes describe the skeletons of logical alternative futures for China.

In developing a consolidated set of multi-domain scenarios it is important first to focus on the pre-determined elements that, although largely unchanging, will continue to play powerful roles in shaping China's trajectory. There are two particularly important categories of pre-determined elements: geography and demography.

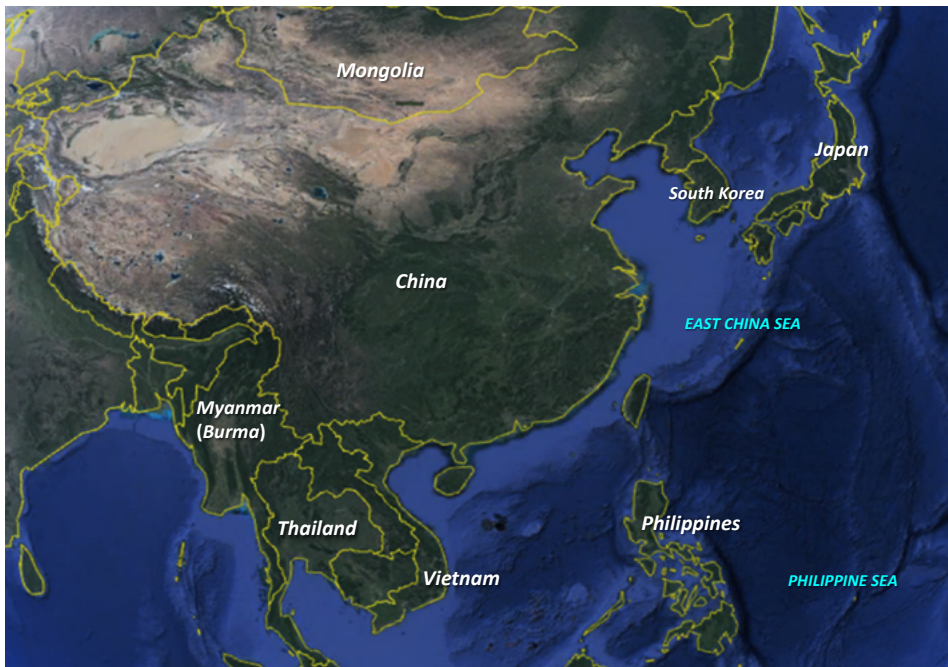
## Pre-determined Elements of Consolidated Scenarios

### Pre-determined Element #1: Geography

Geography plays a foundational role in Chinese strategic perceptions. While the country is of comparable size to the United States, it has few of the natural protections enjoyed by North America. China shares land borders with 15 countries, and it has unresolved border disputes with several of them. Over the millennia many Chinese regimes have been forced to fight for their survival against powerful invaders that swept across the Eurasian plains or assaulted across the eastern seaboard. The country's few geographical barriers and natural vulnerabilities have helped to foster a strong civilizational identity and deep nationalism.

China has traditionally seen itself as more of a continental than a maritime power. It has strategically important overland links, especially to Russia, Central Asia, Southeast Asia, and, to a limited degree, the Middle East and Eastern Europe. In recent years Chinese strategic and economic planners have sought to reinforce these ties through programs such as the Belt and Road Initiative, partially driven by an aspiration to become the dominant power on the Eurasian landmass.

**FIGURE 3: CHINA'S IMMEDIATE SECURITY ENVIRONMENT**





When Chinese security planners look east across the near seas and the expanses of the Pacific Ocean, they see economic opportunities but they also worry about the accessibility of the country's coastal provinces to hostile maritime powers. Offshore, they also note the strategic significance of the island chains that lie between the Chinese mainland and the central Pacific. They appreciate the potential to hold hostile powers at bay by seizing relevant parts of the first island chain, such as Taiwan; creating new islands, such as in the South China Sea; or denying hostile military forces access to other parts of the island chains, especially those that command important maritime straits. Chinese defense planners are well aware that in the event of a major conflict, control of the island chains may be critical to the course of the war. If key offshore islands are held by the People's Liberation Army (PLA) then China's near seas could become relatively secure transit zones for more distant maritime operations. Alternatively, if the island chains are held almost exclusively by the United States and its allies, there is a risk that the PLA Navy will be bottled up behind the allies' barrier defenses and effectively neutralized.

**FIGURE 4: CHINA'S VIEW OF THE ISLAND CHAINS IN THE WESTERN PACIFIC**



A further important geographic factor is China's continuing reliance on long international shipping routes, especially for the import of essential energy and raw materials. These bulk imports mostly come from the Middle East, Australia, and Southeast Asia, and they are critical to the continued operation of many sectors of the Chinese economy. In recent years Beijing has launched numerous initiatives to reduce these exposures, so far with limited success.

**FIGURE 5: PRIMARY INDO-PACIFIC SHIPPING ROUTES**

Kiln and University College London, "Visualization of Global Cargo Ships," available at: <https://www.shipmap.org/> The passage frequency and routing of different types of ships is indicated by the colored lines. Yellow = container ships, Mid-blue = dry bulk carriers, Red = tankers, Light blue = bulk gas carriers, Pink = vehicle carriers.

Another factor that exacerbates many of China's geo-strategic challenges is that while Beijing currently enjoys relatively warm relationships with the Putin regime in Russia and with a few other revisionist regimes, it has no major allies or reliable international partners. Unless this changes, the Chinese regime will need to achieve the substantial progress it desires largely through its own efforts and without triggering strong counteraction by the rest of the world.

### **Pre-determined Element #2: Demography**

Demography is a relatively stable variable in China's future because most of the people who will be in the country in 2035 have already been born. This means that short of a huge catastrophe, there is little that the Chinese Communist regime can do to significantly alter the demographic trajectory of the country this side of 2050. The demographic die is cast.

There are currently about 1.4 billion people in China, but the population is scheduled to peak in about 2028 and decline at an increasing rate during the following decades.<sup>4</sup> The impact of this negative growth is already being felt in parts of the economy because the number of Chinese of workforce age is already falling, and this rate of decline is accelerating. By 2030 there are expected to be 45 million fewer people in the Chinese workforce than in 2016.<sup>5</sup> These and related trends are partly a result of the three and a half decades of the one-child policy that was introduced in 1979. The impact of this and related social policies has been profound and will endure.

China's State Statistical Bureau announced in 2016 that the country's fertility rate (the average number of children born to each female) had fallen to 1.05, half the rate required to sustain the population at its current level and the lowest level reported by any nation.<sup>6</sup>

Part of the problem is a reluctance of young Chinese adults to marry. Current projections suggest that by 2040 some 20 percent of Chinese below the age of 40 will have never married.<sup>7</sup> Rates of divorce are also relatively high.

China's population is also characterized by a serious gender imbalance. The one child policy amplified the preference of Chinese parents to have sons rather than daughters. Millions of girls were aborted or killed at birth. In consequence, across the country there are now an average of 120 Chinese males for every 100 females.<sup>8</sup> However, in some rural provinces there are up to 150 males for every 100 females.<sup>9</sup> In 2049 this gender disparity is expected to result in 23 million more men than women.<sup>10</sup> A large proportion of these unmarried men are likely to live in rural areas, possess limited education, and be poor. Some analysts have argued that this could become a catalyst for future domestic and international instability.<sup>11</sup>

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4 Nicholas Eberstadt, *China's Demographic Outlook to 2040 and Its Implications*, (Washington, DC: American Enterprise Institute, 2019), available at <https://www.aei.org/wp-content/uploads/2019/01/China%E2%80%99s-Demographic-Outlook.pdf>.

5 Ibid., p. 6.

6 Joan Kaufman, "China Now Has the Lowest Fertility Rate in the World," *The National Interest*, December 1, 2016, available at <https://nationalinterest.org/blog/the-buzz/china-now-has-the-lowest-fertility-rate-the-world-18570>.

7 Nicholas Eberstadt, *China's Demographic Outlook to 2040 and Its Implications*, pp. 13-14.

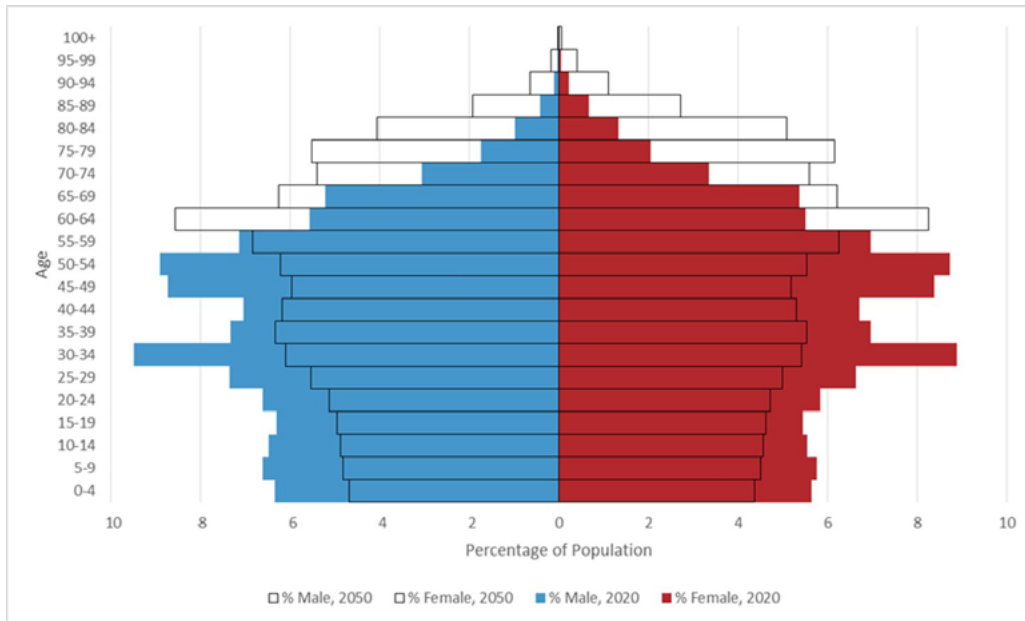
8 Ibid., p.12.

9 "China's Marriage Rate Plummetts," *People's Daily Online*, June 29, 2018, available at <http://en.people.cn/n3/2018/0629/c90000-9476075.html>.

10 Nicholas Eberstadt, *China's Demographic Outlook to 2040 and Its Implications*, p.14.

11 Valerie M. Hudson and Andrea M. den Boer, *Bare Branches: The Security Implications of Asia's Surplus Male Population* (Cambridge, MA: Massachusetts Institute of Technology Press, 2005) and Nicholas Eberstadt, *China's Demographic Outlook to 2040 and Its Implications*, p. 14.

FIGURE 6: CHINA'S PATTERN OF GENDER IMBALANCE



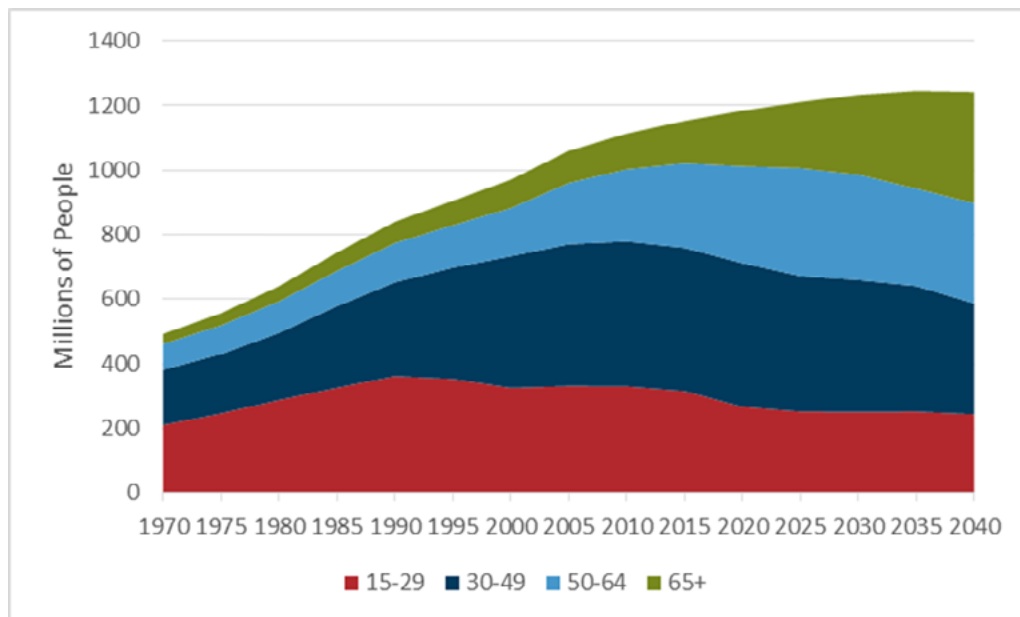
Source: UN Department of Economic and Social Affairs, Population Division, 2019 Revision of World Population Prospects, 2019, <https://population.un.org/wpp/> Graphic inspired by Nicholas Eberstadt, *China's Demographic Outlook to 2040 and Its Implications*, (American Enterprise Institute, Washington D.C. 2019), p.5, <https://www.aei.org/wpcontent/uploads/2019/01/China%E2%80%99s-Demographic-Outlook.pdf>

Another serious consequence of China's very low birth rate is that the population is now aging rapidly. The overall pattern is displayed in Figure 7. The number of people over 65 years of age is projected to grow from 135 million in 2015 to 340 million in 2040.<sup>12</sup> During the same period the number of Chinese below 35 years of age is expected to fall by almost the same 135 million.<sup>13</sup> This trend portends vast changes in China's society, national, and provincial budgets and in its economic prospects.

12 Nicholas Eberstadt, *China's Demographic Outlook to 2040 and Its Implications*, p. 9.

13 Ibid.

FIGURE 7: THE CHANGING AGE DISTRIBUTION OF THE CHINESE POPULATION



Source: UN Department of Economic and Social Affairs, Population Division, 2019 Revision of World Population Prospects, 2019, <https://population.un.org/wpp/> Graphic inspired by Nicholas Eberstadt, *China's Demographic Outlook to 2040 and Its Implications*, (American Enterprise Institute, Washington D.C. 2019), p.5. <https://www.aei.org/wpcontent/uploads/2019/01/China%E2%80%99s-Demographic-Outlook.pdf>

At present, 65 percent of Chinese over the age of 65 are paid a state pension but they only receive the equivalent of US\$10 per month.<sup>14</sup> There are marked differences between the capacities of individual provinces to provide pension support to the elderly but nearly all provinces, especially those in rural areas, are already straining to support pension, health, and other support services. There have been reports that current pension funds may expire in the mid-2030s.<sup>15</sup>

A key consequence is that the rapidly rising numbers of elderly Chinese will impose new and very substantial strains on China's national and provincial budgets. At present there are about six fully employed people for every person over 65 but by 2030 this is expected to fall to four and by 2050 to two.<sup>16</sup>

These trends are already having profound impacts on traditional Chinese family life, on Chinese culture, on the urban-rural divide and on income and social disparities. Xi Jinping

14 "China's Social Security System," *China Labour Bulletin*, updated October 15, 2019, available at <https://clb.org.hk/content/china%E2%80%99s-social-security-system>.

15 Yang Kunyi, "Urban pension funds likely to run out by 2035: CASS Report," *Global Times*, April 11, 2019, available at <http://www.globaltimes.cn/content/1145607.shtml>.

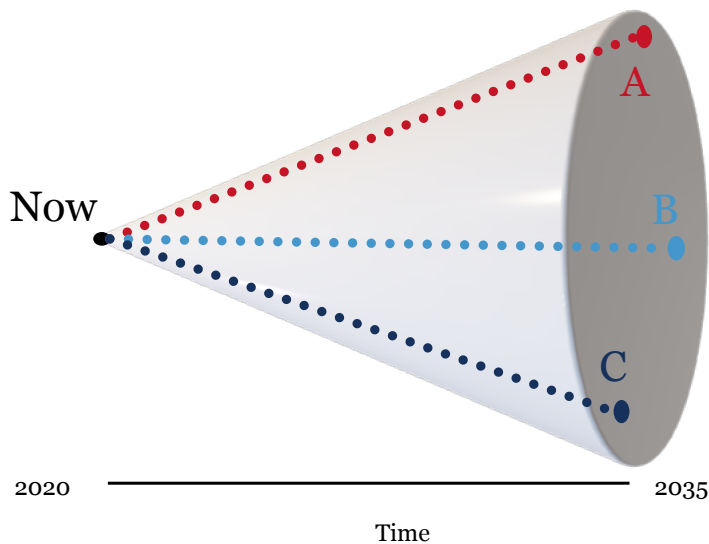
16 Qiushi Feng, Wei-Jun Jean Yeung, Zhenglian Wang, and Yi Zeng, "Age of Retirement and Human Capital in an Aging China, 2015–2050" *European Journal of Population* 35, no. 1, February 2019, pp. 29-62.

has described these corrosive influences as “gray rhinos.”<sup>17</sup> The implications for the governance of China and for its future trajectory will be substantial and most likely enduring.

## The Driving Forces for Consolidated Scenarios

When the predetermined elements described above are supplemented by the most important driving forces, a reasonably comprehensive picture is painted of China’s situation in Year Zero—in 2020. This is depicted graphically at the left-hand end of Figure 8.

**FIGURE 8: PROGRESSION OF LEAD INDICATORS TO ALTERNATIVE SCENARIOS IN 2035**



Five primary driving forces are identified and discussed in the four domain papers at Annexes C, D, E and F. They are, as follows:

### **Driving Force #1. The power, performance and durability of the Chinese Communist Party regime.**

A leading question is whether or not the Chinese Communist Party (CCP) retains its monopoly on political power during the period to 2035.

As Aaron Friedberg and Nadège Rolland argue in Appendix C, if it were not for the ruthlessness, resolve, and increasing resources of the CCP, China might already have followed the path of other countries with authoritarian regimes and made a transition to democracy. The

17 Willy Wo-Lap Lam, “Xi Jinping Warns Against the ‘Black Swans’ and ‘Gray Rhinos’ of a Possible Color Revolution,” *China Brief* 19, no. 5, February 21, 2019, available at <https://jamestown.org/wp-content/uploads/2019/03/Read-the-03-05-2019-CB-Issue-in-PDF1.pdf?x46748>.

factors and forces constraining political change have simply remained stronger than those driving change. Indeed, during the last decade Xi Jinping has also gone even further than his predecessors in suppressing dissent, shutting down NGOs, persecuting human rights advocates, intensifying repression of alleged Uighur and Tibetan “separatists,” and imposing ever tighter controls on the internet and social media.

But Xi does not seek to rule by repression alone. New ideological indoctrination campaigns have been aimed at party members and at ordinary citizens. Xi has also adopted a more assertive foreign policy stance that is intended, at least in part, to stir nationalist sentiments and mobilize popular support for the regime.

Last but not least, Xi clearly acknowledges the need for sustained measures to maintain strong economic growth. At least in the near term, he is doing this by further loosening credit, spending even more on infrastructure development and maintaining and in some cases extending subsidies to domestic industries, mostly in state-owned sectors. In the medium and longer term Xi is counting on massive state-directed industrial policy programs, like the Made in China 2025 initiative, to propel “national champions” to dominant positions in global markets across a wide range of high-tech sectors. Xi Jinping dreams of a technologically empowered totalitarianism, a more capable successor to the less efficient systems of the twentieth century in which advances in science and engineering enable innovation and sustained growth coupled with complete societal control.

But Xi’s plans may fail, in whole or part. Reducing economic competitiveness, weakened ideological credibility, expanding corruption, and rising elite tensions may combine to undermine the regime. At some point, a breakdown in cohesion could lead in many different directions, including to coups, civil wars, and mass revolts. Nevertheless, the likelihood of a true popular revolution sweeping the current regime from power currently appears low.

There are therefore many questions concerning the outlook for the Chinese Communist Party regime. Will Xi Jinping continue to double down on party surveillance, controls, and discipline or will there be some liberalizing reforms in the economy, in politics and elsewhere? Will there be increased domestic dissent and, if so, how will the regime respond? What are the prospects of the regime, when under pressure, rallying the party and nation by launching new rounds of nationalist propaganda, perhaps accompanied by aggressive international actions? What would need to happen for Xi Jinping to step down and be replaced by a collective leadership or by an individual with more moderate instincts? And what type of changes would be required for the regime to collapse?

## **Driving Force #2. The economic, technological, and corporate progress of the country.**

In Appendix D, Julian Snelder argues that there are many uncertainties regarding China’s economic future.

China's economy has certainly grown strongly since the 1980s, but in recent years trouble has been brewing. The official growth rate more than halved from 13 percent in 2007 to about 6 percent by the end of 2019 and the World Bank,<sup>18</sup> the Australian Reserve Bank,<sup>19</sup> and even the Chinese Premier<sup>20</sup> were all predicting a further slowing. Moreover, many leading economists believe that China's official figures have long been falsified<sup>21</sup> and that the actual growth rate in January 2020 was in the 4-5 percent range or even lower.<sup>22</sup> On top of this declining trend, official figures indicate that the virus shrank the Chinese economy by 6.8 percent during the first quarter of 2020<sup>23</sup>—although credible reports indicate that the slump has been larger.<sup>24</sup> In the medium and longer term, the Australian Reserve Bank has stated that China's growth rate will likely be around 3 percent by 2030.<sup>25</sup> Others are predicting 1-1.5 percent by 2040.<sup>26</sup> These figures would mean that in two decades' time China's economy would still be very large, but it would be running at about the same pace as that of the United States, and possibly slower.

Another dimension of China's weakening economy is that the country's debt now exceeds 300 percent of GDP.<sup>27</sup> National debt has been growing at a rate exceeding that of any other country in peacetime. Measures to service and reduce this debt are likely to further constrain economic growth.

In efforts to maintain economic momentum and political stability, Beijing has launched a succession of stimulus packages in recent years. But much of this spending has been unproductive. Very fast train lines and highways have been built to sparsely inhabited

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18 The World Bank, 2019, <https://data.worldbank.org/country/china>

19 Alexandra Veroude, "Australia's Central Bank Sees China Slowing to About 3% by 2030," Bloomberg News, December 12, 2019. <https://www.bloomberg.com/news/articles/2019-12-12/australia-s-central-bank-sees-china-slowng-to-about-3-by-2030>

20 "It's 'very difficult' for China's economy to maintain 6% growth, says Premier Li Keqiang," CNBC, September 16, 2019. <https://www.cnbc.com/2019/09/16/china-economy-difficult-to-maintain-6percent-growth-says-pm-li-keqiang.html>

21 Gabriel Wildau, "China's economy is 12% smaller than official data say, study finds," Financial Times, March 7, 2019. <https://www.ft.com/content/961b4b32-3fce-11e9-b896-fe36ec32aece?segmentId=a7371401-027d-d8bf-8a7f-2a746e767d56>

22 Sun Yu. "State Grid warns that China GDP at risk of slipping to 4%," Financial Times, January 16, 2020. <https://www.ft.com/content/0bb37c2e-3755-11ea-a6d3-9a26f8c3c3ba4>

23 "China's GDP Falls at Double-Digit Rate" AEI, April 17, 2020. <https://www.aei.org/foreign-and-defense-policy/chinas-gdp-falls-at-a-double-digit-rate/>

24 Ibid.

25 Ivan Roberts and Brendan Russell, 'Long-term Growth in China Long-term Growth in China'. Reserve Bank of Australia Bulletin, December, 2019, <https://www.rba.gov.au/publications/bulletin/2019/dec/long-term-growth-in-china.html>

26 'A Stagnant China in 2040, Briefly' AEI, March 16, 2020. <https://www.aei.org/research-products/report/a-stagnant-china-in-2040-briefly>

27 'China's debt tops 300% of GDP, now 15% of global total: IIF' Reuters, July 18, 2019, <https://www.reuters.com/article/us-china-economy-debt/chinas-debt-tops-300-of-gdp-now-15-of-global-total-iif-idUSKCN1UDoKD>



regions.<sup>28</sup> More than 50 “ghost cities” have been constructed containing empty apartment blocks, offices, shopping malls and airports.<sup>29</sup> Over 20 percent of homes in China are currently vacant.<sup>30</sup> About a third of China’s production capacity is believed to be surplus to requirements.

The regime has further distorted the economy by driving the banks to favor state-owned companies over much more productive and efficient private sector enterprises.<sup>31</sup> During the last decade, the state’s share of fixed asset investment has crept back up from 30% to 40%.<sup>32</sup> State-affiliated firms enjoy 80% of new lending by the formal banking sector; indeed, the private sector’s share has shrunk by 80% since 2013.<sup>33</sup> These and related practices have led to high levels of non-performing loans,<sup>34</sup> bank failures,<sup>35</sup> many defaults on corporate bond payments and record levels of bankruptcy.<sup>36</sup> The economic impact of the virus has further aggravated these weaknesses.

Another problem is that national productivity is falling, with China losing its competitiveness in many sectors.<sup>37</sup> In recent years foreign investments have been driven more by the desire to gain access to the large Chinese market rather than to take advantage of highly-competitive manufacturing capacities. Indeed, numerous foreign manufacturers have been

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- 28 Michael Beckley ‘The United States Should Fear a Faltering China: Beijing’s Assertiveness Betrays Its Desperation’ *Foreign Affairs*, October 28, 2019. <https://www.foreignaffairs.com/articles/china/2019-10-28/united-states-should-fear-faltering-china>
- 29 Ibid.
- 30 Ibid.
- 31 Minxin Pei, ‘China’s Coming Upheaval’ *Foreign Affairs*, May-June 2020. <https://www.foreignaffairs.com/articles/united-states/2020-04-03/chinas-coming-upheaval>
- 32 “China Fixed Asset Investment: YTD: State-Owned and Holding Enterprises, 2004–2017,” CEIC, available at: <https://www.ceicdata.com/en/china/fixed-asset-investment-enterprise-and-work-type/fixed-asset-investment-ytd-state-owned--holding-enterprises>
- 33 Nicholas R. Lardy, *The State Strikes Back: The End of Economic Reform in China?* (Washington, DC: Peterson Institute for International Economics, January 2019); Lardy, “Xi Jinping’s turn away from the market puts Chinese growth at risk,” *Financial Times*, January 15, 2019, available at: <https://www.ft.com/content/3e37af94-17f8-11e9-b191-175523b59d1d>; and Tom Mitchell, Xinning Liu, and Gabriel Wildau, “China’s private sector struggles for funding as growth slows,” *Financial Times*, January 21, 2019, available at: <https://www.ft.com/content/56771148-1d1c-11e9-b126-46fc3ad87c65>
- 34 Don Weinland, ‘Corporate defaults in China surge in 2019 to record high \$18.6bn’ *Financial Times*, December 26, 2019. <https://www.ft.com/content/068a83e0-27a7-11ea-93054234e74b0ef3?desktop=true&segmentId=7c8f09b9-9b61-4fbb-9430-9208a9e233c8#myft.notification:daily-email:content>
- 35 Stephen Joske, ‘China’s financial risk and lessons from the Baoshang Bank collapse’, *The Interpreter*, June 28, 2019. <https://www.lowyinstitute.org/the-interpreter/lessons-baoshang-bank-collapse>
- 36 Don Weinland, “Corporate defaults in China surge in 2019 to record high \$18.6bn”, *Financial Times*, December 26, 2019. <https://www.ft.com/content/068a83e0-27a7-11ea-93054234e74b0ef3?desktop=true&segmentId=7c8f09b9-9b61-4fbb-9430-9208a9e233c8#myft.notification:daily-email:content>
- 37 David Fickling “China Could Outrun the US Next Year—or Never,” *Bloomberg News*, March 19, 2019. <https://www.bloomberg.com/opinion/articles/2019-03-08/will-china-overtake-u-s-gdp-depends-how-you-count?srnd=premium-asia>

moving offshore and wealthy Chinese have been shifting large sums out of the country, despite regime attempts to stem the flow.<sup>38</sup>

In the face of this deteriorating situation the regime has been investing heavily in new technologies in the hope that the *Made in China 2025* and related programs will push China to the lead in key next-generation technologies and industrial capabilities.<sup>39</sup> Beijing has also been working for over 15 years to reduce the country's exposure to the international economy. China's exports as a percentage of GDP halved from 36 percent in 2006 to 17 percent in 2019.<sup>40</sup> Then in May 2020, Xi told his top economic advisers that China would accelerate its move away from international markets towards a more closed economy in which "domestic circulation plays the dominant role."<sup>41</sup> This strategic shift will reduce the regime's vulnerability to international pressures. Probably more importantly from Xi's perspective, this accelerated introversion will increase the level of control that the party can exercise over China's economic future.

An interim conclusion is that the party's assertion that the Chinese economy continues an inexorable rise to dominate the world is not supported by the facts. The Chinese economy may be approaching the size of the U.S. economy but it now has serious structural and operational problems and its future trajectory is very uncertain.

Julian Snelder concludes that there are three central questions concerning China's economic future. First, will China experience high economic dynamism via technological innovation, or will it succumb to some form of middle-income trap?<sup>42</sup> Second, will China's economic institutions continue to be dominated by the party, or will the regime permit corporate leaders to drive the development of their enterprises? And third, will China open internationally across a broad range of economic sectors, or will it remain relatively insular and selective in its international interactions? The answers to these questions will largely

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38 "China's Hidden Capital Flight Surges to Record High," *Bloomberg News*, October 11, 2019. <https://www.bloomberg.com/news/articles/2019-10-11/china-hidden-capital-flight-at-a-record-in-2019-'-says>

39 *Made in China 2025: A New World Order?* J.P. Morgan Perspectives, January 31, 2019, <https://diplomatizzando.blogspot.com/2019/01/jp-morgan-perspectives-made-in-china.html>

40 Joseph Wang, 'Let's say Trump serves both terms and keep pushing tariffs on China like he's doing now. By the time he steps down how different will China's economy be?' Quora, September 24, 2018. <https://www.quora.com/Lets-say-Trump-serves-both-terms-and-keep-pushing-tariffs-on-China-like-hes-doing-now-By-the-time-he-steps-down-how-different-will-Chinas-economy-be> See also: Trading Economics, SMSF Factsheets <https://tradingeconomics.com/china/exports-of-golods-and-services-percent-of-gdp-wb-data.htm>.

41 Frank Tang, 'China's economic strategy shift shows Xi Jinping is preparing for 'worst case scenario', analysts say.' *South China Morning Post*, May 20, 2020. <https://www.scmp.com/economy/china-economy/article/3085969/chinas-economic-strategy-shift-shows-xi-jinping-preparing>

42 The middle-income gap is a short-hand descriptor of the situation when that arises when a developing country grows very rapidly as it industrializes and urbanizes but then experiences difficulty in sustaining high growth rates of growth sufficient to enable continued improvements in levels of per capita income. China is now confronted by this risk. See this discussed in Sagatom Saha, "The Future of Chinese Foreign Economic Policy Will Challenge U.S. Interests, Part 1: The Belt-and-Road Initiative and the Middle Income Trap," *China Brief* 20, no. 2, January 29, 2020, available at <https://jamestown.org/program/the-future-of-chinese-foreign-economic-policy-will-challenge-u-s-interests-part-1-the-belt-and-road-initiative-and-the-middle-income-trap/>.

determine whether China's rate of economic growth in coming years is 8 percent, 6 percent, 4 percent, or 2 percent. The direction Beijing takes on the three core questions will also largely determine whether the country returns to a 'Dengist' style of economic management, whether the decline in China's productivity can be reversed, and whether large Chinese corporates emerge to dominate global markets. These variables will clearly have a strong influence on China's future trajectory.

**Driving Force #3. The extent to which China's modernized military is employed aggressively beyond China's borders and the level of international cooperation or resistance that confronts China.**

Xi Jinping has made it clear that powerful ground, air, naval, and rocket forces are key instruments for advancing China's national interests. As Toshi Yoshihara argues in Appendix E, military power also reinforces China's rising status in international politics. Xi has pledged to build a potent military in a three-step process. First, the PLA will have completed the mechanization process and made substantial strides in "informationization" by 2020. Second, the PLA will have completed its modernization by 2035. Then, third, the PLA will be "fully transformed into world-class forces" by the mid-century.

The first strategic driver for the regime in the military domain is to build strategic leverage over the future of Taiwan. On the one hand, if Taiwan's future status were resolved it would free China from a high-intensity conflict that could involve the United States, Japan, and other third parties. Alternatively, if Taiwan's status remains unresolved it could continue to fixate Beijing's attention and consume China's resources as it prepares for a potential offshore military campaign.

The second key determinant of China's military investments is the health of the U.S.-led alliance architecture in Asia. If the alliance system is in disarray it would be vulnerable to subversion and attack. Alternatively, if Beijing could see an overlapping network of alliance relationships coalescing around the Chinese periphery, the PLA's strategic leverage could be severely constrained.

There are many uncertainties about the drivers of China's military development and operations during the next decade and a half. There is a possibility that the international community will become increasingly affronted by the CCP's ideology, political, and hybrid warfare operations and generate much stronger headwinds for China's international operations. In that sort of environment will Taiwan substantially strengthen its defenses and rally its domestic population to resist the Chinese regime? Will the United States, Japan, and other countries reinforce Taiwan's security by supplying substantially expanded military equipment, technology, and diplomatic support? Alternatively, will the Western allies continue to be hesitant about bolstering Taiwan's security and will the Taiwanese relax their security and weaken their resistance to Beijing?

#### **Driving Force #4. If the challenges now confronting the Chinese regime develop further, will it seek to rally the country by adopting highly nationalistic rhetoric and international stances?**

One of the most powerful instruments available to Chinese regimes is nationalism. This is a force that is already used by Xi Jinping to inspire the country to strive to achieve the “China dream” and restore the country to its “rightful international place.” Moreover, Beijing periodically uses nationalist propaganda to increase pressure on countries that fail to act in accordance with the regime’s wishes. Notable cases in recent years have been campaigns against Japan and South Korea, with large numbers of people organized to boycott particular foreign products, force the closure of foreign-owned enterprises, and intimidate foreign nationals.

Should Xi Jinping or a future leader be under severe pressure and to sense a need to rapidly reinforce the regime’s domestic legitimacy, much stronger nationalist stances could be taken at short notice. Propaganda could be ramped up, economic sanctions could be imposed, and international actions could be taken that would be expansionist, provocative, and very risky. The circumstances that might trigger such actions could include a major regime failure, perhaps concerning the management of a civil disaster; a major military setback; or a dramatic economic reverse.

These types of crises could readily escalate were the Chinese regime to attempt to bully one or more Western allies. The regime could feel compelled to launch a dramatic international adventure, such as an assault on Taiwan, to “unify the country,” silence dissenters, and distract the domestic population. If the primary drivers of such actions were domestic and concern the core security of the regime, they may be very difficult for the United States and its Pacific allies to deter.

#### **Driving Force #5. The extent to which the Chinese regime expands its international political, economic and military footprint in key parts of the Indo-Pacific region and beyond.**

Aaron Friedberg and Nadège Rolland argue in Appendix F that there are two primary forces that will determine whether Beijing pushes hard to expand its political, economic, and military footprints internationally. The first will be the rate of growth in China’s “comprehensive national power” and the manner in which the nation’s leaders define its interests and objectives. The second driving force will be the capabilities of a nascent coalition of other nations and the extent to which they perceive the necessity, and have the ability, either to accommodate China or to work together to counter the potentially harmful effects of its rise.

This report argues that when China experiences rapid growth in its relative wealth and power, it will seek to alter, and may attempt to overthrow or fundamentally transform, the international system of which it is a part, including existing rules and institutions, patterns

of trade and investment, territorial boundaries, and hierarchies of prestige that were created when it was relatively weak.

There is, however, also a strong tendency towards balancing in international politics. Fearful that a rapidly rising power could threaten their interests, their autonomy, and perhaps even their survival, the other states in an international system will generally take steps to defend themselves. Balances of power do tend to form in international politics, but they may not emerge quickly enough to deter or defeat initial acts of aggression by ambitious rising states.

Again, there are many variables at play and a large number of future possibilities. Will the regime work harder to export its model of governance? Will it re-direct its political, economic, military, and other national instruments to build an enduring alliance of authoritarian and revisionist states? Will Beijing increase or decrease its investments in the Belt and Road Initiative? Will the regime expand its efforts to influence or control major international institutions and international rule-making systems? Western security organizations need to acknowledge this diversity of possibilities within an agile security planning system.



## CHAPTER 3

# The Scenario Stories

Having identified and described the main pre-determined elements and driving forces, it is now possible to combine them in various ways to produce a set of four consolidated scenarios. Each of these scenarios draws on the expert analyses in Appendixes C, D, E, and F and each is both internally consistent and credible. This report argues that, as a set, the four scenarios are representative of the scenario space that can be anticipated for China in 2035. The four consolidated scenarios are:

1. Xi Jinping's Dream;
2. Muddling Through;
3. Nationalist Drive;
4. Macro-Singapore.

Each of the future scenarios is described below as a retrospective from the hypothetical situation of China in 2035.

### **Scenario 1: Xi Jinping's Dream**

Looking back, it's now clear that Xi Jinping's dramatic policy reversal really began in 2018–2020. Although few in the West noticed at the time, Xi and his senior party colleagues were receiving a stream of disturbing reports about the weakness of the Chinese economy, the pace and scale of the demographic decline, and the increasing resolve of the U.S. and its close allies to rally the international community to confront Beijing. Worse still, Xi started to receive intelligence reports indicating that the Americans were making rapid progress in developing and deploying a new generation of advanced military systems that had the potential to change the game in the Western Pacific. He realized that the vast investments China had made in fourth-generation military systems during the previous two decades could be made obsolete within three to five years.

It was not just the party elite that was uneasy. Behind the scenes many others were deeply disturbed by Xi Jinping's behavior, especially when he provoked the Americans to engage in a trade war, tighten technology controls, and stiffen the West's strategic stance. Xi sensed the Party unease and realized that change was needed. He decided to move swiftly.

On 14 December 2020, Xi Jinping delivered a two-hour speech to a gathering of national and provincial party leaders announcing a new focus for business and economic reform that he called "Socialist Incentivization." Xi said that the party was determined to accelerate programs of economic and business reform and he promised "rich rewards for those who move rapidly to improve national productivity, sharpen competitiveness, and win new markets at home and abroad." As part of this program, Xi foreshadowed legislation to provide "deep protection" for intellectual property, the introduction of a Hong Kong-style system of property title and land management, and the launching of several measures to boost investment and reduce business costs.

Then, in March 2021, Xi Jinping announced major technological breakthroughs in quantum computing and 6G telecommunications. He re-stated his vision for China to lead the world in key advanced technologies and he pressed all Chinese citizens to "strive energetically to help China reach its manifest destiny."

Meanwhile, in Washington, the fall-out from the November 2020 election brought more intense domestic divisions, not least in Congress. Despite Washington's disarray, the President moved forward to conclude a wide-ranging trade and economic agreement that Xi Jinping called a "historic new economic partnership."

The United States and its close allies were further disrupted when, in June 2021, a major conflict erupted between Iran and Israel. There were intense missile attacks and bombing raids and a two-month Israeli assault against Iranian and Hezbollah forces in Syria and Lebanon. Extensive American military support flowed to Israel, and some Russian and Chinese supplies were delivered to Iran. The end result was that while both sides suffered extensive casualties, the Iranian regime suffered most. Nearly all of Iran's nuclear and high technology military and industrial capabilities were destroyed, but the price paid by Washington was high. The U.S. administration was heavily distracted for many months and was forced to carry the burden of reestablishing a major military presence in the Middle East to underpin Israel's security and ensure the maintenance of stable energy supplies.

With the Americans heavily committed elsewhere, Beijing lifted the scale and tempo of its political warfare operations in the Indo-Pacific and increased the frequency of its military visit and exercise activity in Southeast Asia, the South Pacific, and the Indian Ocean. More regional countries came to appreciate the success of China's second wind economic reforms and Beijing's political ascendancy was carried to new heights.

In 2023–24, Xi Jinping announced a further suite of economic reforms designed to gradually wind back national debt, improve business efficiency, and outflank foreign competitors



in key high technology sectors. The international business community generally welcomed these initiatives. They were seen to be necessary steps in bedding-down China's economic development for the medium and longer term. A surge of foreign investment flowed into China.

Then, in March 2024, Xi delivered a major address to the party elite in which he acknowledged the serious errors of the one child policy in the 1970s, 80s, and 90s and launched a major campaign to encourage young couples to marry and have more children. Loosely modelled on Singapore's "Have three or more" campaign, Xi explained that it was a national duty for young people to have children, create stable families and restore China's demographic stability. In an effort to ease the gender imbalance he also announced major modifications to China's immigration regulations to facilitate the entry of foreign-born wives, especially those coming from Chinese communities abroad.

In January 2025, Xi Jinping announced important banking reforms to improve the resilience of the financial sector but also to improve the quality of the services offered to businesses and households.

Then, in May 2025, the PLA formally established naval and air support facilities in Myanmar and the Seychelles and a major extension of its existing facilities in Cambodia. In opening the facilities in the Seychelles, Xi Jinping said that China was well advanced in being able to provide uninterrupted air and surface protection for ships travelling to and from the Persian Gulf and the Suez Canal through the Indian Ocean and the South East Asian straits to China. He called this capability the "Golden Seaway," and encouraged the vessels of other countries to take advantage of China's expanding network of security protection.

Highlights of 2026 included the successful negotiation of a wide-ranging security and mutual defense treaty with Russia and Xi Jinping's first visit to Antarctica to open four new Chinese research support stations. Beijing also launched a new, very sophisticated political warfare campaign against the government in Taipei. One of the consequences was to refresh debate in Taiwan about the potential benefits of reunification with the mainland.

By the time of the major party congress in 2027 the success of Xi's drive for China's "new economy, new era" was assured. His position as Party Secretary and national President was confirmed not only for the following five years, but for an indefinite period. The mainstream Chinese press now routinely referred to Xi as the "People's Leader" and "Father Xi".

In 2029, the United States remained deeply polarized, heavily distracted by domestic issues, and struggling to maintain peace and security in the Persian Gulf, Syria, and on its own border with Mexico. Meanwhile, Chinese agencies were very active in offering inducements to governments and individuals in key countries in Southeast Asia, the South Pacific, and East Africa to support Beijing's international goals. Some progress was made in exporting China's model of governance, building high-level political linkages and in establishing air

and naval access agreements in the Philippines, the Solomon Islands, Fiji, Tanzania, and South Africa.

Late in 2029, the PLA launched a very large naval and air exercise in the southern end of the South China Sea and then a second in April 2030 in the vicinity of Taiwan and Japan. During this period Beijing further extended its political warfare campaign against Taiwan, aiming to divide the community and undermine its resilience. The U.S. administration expressed displeasure but did not respond with any effective countermeasures.

Then the PLA launched an even larger exercise around Taiwan in May 2031. Beijing combined this intense military activity with an offer to the Taiwanese Government promising Taipei special status and a large degree of self-government for 100 years if it agreed to merge with the PRC. With PLA naval and air forces operating in a threatening manner within Taiwan's territorial waters, the political leadership in Taipei lost its nerve and agreed to negotiate. A long-term peace agreement was concluded with Beijing in December 2031.

During the following six months the PLA established major air, naval, and ground force bases in Taiwan and commenced active operations to exploit this breach in the first island chain. The Taiwanese armed forces and related agencies were rapidly integrated into the PLA.

In 2034, Xi Jinping celebrated China's successful manned landing on Mars. Xi also used this seminal event to claim that China was well on the way to "fulfil the China dream by the centenary of the Chinese Communist Party in 2049."

## **Scenario 2: Muddling Through**

When Han Qiang, the party leader in Shanghai, arrived at the 2021 leadership retreat at the coastal resort of Beidaihe, he was very agitated. At the first opportunity he spoke strongly about the incompetence of senior officials in managing the economy. "Why have they presided over such a marked slowing of the economy without taking strong action? Why have they cut spending on much needed infrastructure in China's cities? And why have the state prosecutors turned a blind eye to rampant corruption in the finance sector?"

At first, most party colleagues were stunned by the strength of this attack. But others soon joined Han Qiang in questioning Beijing's handling of the economy. Despite these expressions of concern, it soon became clear that there were sharp differences about what should be done. Some were wanting to boost infrastructure spending at the cost of going further into debt. Others were wanting to further loosen credit restrictions and still others wanted to lighten the party's involvement in corporate decision-making.

Xi Jinping listened intently to these exchanges. While he wasn't expecting such frank debate, he wasn't completely surprised because for several weeks he had been receiving reports of party and public unease about the nation's troubled economic outlook and a rise in the

number of bankruptcies. He believed that further expressions of public dissent, possibly on a large scale, could occur in the months ahead.

Faced with these challenges, Xi Jinping's instincts were consistent and strong. From the time he took over the leadership of the party in 2012 he had emphasized that the party's security was paramount. When he addressed the final meeting at Beidaihe in 2021, he stated that he was determined that all other considerations would remain secondary.

Ten days later Xi embarked on a series of provincial tours to encourage the people to be alert for signs of deviant behavior, warn them of the "struggles" ahead and highlight the need to remain steadfast in striving to achieve the "China dream." He talked about a "new phase of the socialist struggle" and the critical importance of remaining focused on realizing the China dream and winning "the prize."

At the same time, relevant Chinese agencies tightened public surveillance, increased the pace of their counter-corruption campaigns and significantly increased the number of people arrested for subversive activity. Western residents noticed the tightened security controls immediately, especially the reluctance of most local residents to engage with Westerners in any significant discussions. During 2021–23 a number of Xi's political rivals were swept up in these tightened security operations. Most were subsequently charged with corruption offenses and suffered the indignity of show trials. Some were executed.

While these measures tightened security, the regime was slow to take serious action to heal the economic, demographic, and other ills confronting the country. It wasn't until August 2022 that the government further eased credit and announced another package of stimulatory measures. In Shanghai, Han Qiang and some of his senior colleagues could scarcely disguise their frustration at the lack of urgency in Beijing. Han and three other party leaders in coastal provinces spoke openly about the need for "combined efforts" to improve national efficiency, boost consumption and further strengthen the economy. By early 2023, the rate of GDP growth was running at about 3.2 percent, but national debt had risen to more than 400 percent of GDP.

Six months later Xi Jinping moved to further boost growth and employment. Renewed emphasis was given to large infrastructure projects with a particular focus on improved water and sewerage services, reducing pollution, and easing urban congestion. While generally welcomed, these initiatives did little to boost national productivity or competitiveness and received a lukewarm reception from many Chinese economists.

By 2024, international challenges confronting the Chinese regime were also mounting. The United States and its close allies had developed twenty-first century versions of the political warfare systems that they had deployed against the Soviet Union during the Cold War. The primary effect was to reveal many CCP indiscretions and human rights abuses. The international media was not only describing the terrors of Mao Zedong's Great Leap Forward, the Cultural Revolution, and the Tiananmen Square massacre, but also the scale and nature of

the current-day Chinese gulag. Then, in addition, Western Congressional and Parliamentary investigations and media exposés detailed the financial excesses and corruption of key members of the regime. Party leaders were forced to expand propaganda campaigns and further tighten domestic information flows. China's diplomats, "united front" operatives and media agencies tried hard to discredit such stories but with only modest success. Some leakage of this information through the Great Firewall was inevitable. A rising number of Chinese citizens travelling to Western countries for study or business decided to defect.

An even more troubling development for Xi Jinping was the roll-out and demonstration in 2025 of key elements of the United States' new generation military capabilities. The new B-21 *Raider* long-range stealth strategic bomber was entering service, several waves of hypersonic missiles had been deployed, and highly innovative robotic systems were revealed for underwater, surface, air, and space operations. When demonstrated in sophisticated multi-domain operations, it quickly became clear that much of China's heavy investment in fourth-generation military capabilities was about to be rendered obsolete. China's most senior military officers reported this negative development in blunt terms. They advised Xi that the U.S. and its allies were regaining their strategic ascendancy in the Western Pacific. Xi realized immediately that the strategic and political impact would be profound both within the party and abroad.

The international responses to these events were mixed. The newly elected president of the Philippines moved rapidly to expand the scale of the U.S. military presence, the Taiwanese Government welcomed expanded U.S. and allied military and economic ties, and Indonesia, Malaysia, Singapore and India stiffened their resistance to Chinese activities in their environments. To rub further salt into Beijing's wounds, the Western media ran repeated stories about the West regaining its mojo.

By January 2027 China's economic growth rate had fallen to 2 percent. Foreign investment had receded to low levels and capital flight had risen to the highest levels in half a century. While China did produce some technological successes during this period, most notably in telecommunications, biotechnologies, and advanced sensor systems, these had only modest impacts on the broader economy, national prosperity and employment.

Meantime, Xi Jinping saw a need to do something about the aging of the population and also to distract the people from the nation's economic and military disappointments. During 2027–28, he worked with provincial governments to ensure that a basic pension was available to the surging numbers of elderly. He also launched a sustained propaganda campaign to champion family life and the desirability of early marriage and raising children. Part of this effort saw the funding of a nationalistic youth movement called *Pathfinders*. However, the practical effects of these initiatives were modest. Indeed, they had the unexpected consequence of helping to stir resentment in many communities about the stark inequities characterizing Chinese society.

In an effort to counter Western advances abroad, Xi Jinping expended considerable effort in the late 20s to revitalize and extend the Belt and Road Initiative. Substantial new funding was allocated, leading technical experts were lent to several developing countries, and Xi personally encouraged additional governments to join a new development and security partnership. While some countries agreed to participate, few were enthusiastic, perceiving China's waning economic and strategic fortunes to offer little that was not available elsewhere. Moreover, during this period, U.S. and allied exposure of the Chinese regime's corruption and human rights record took the regime's soft power in many countries into negative territory.

By 2029–30 Xi Jinping was placing much greater emphasis on nationalist themes in his presentations at home. A key thrust was the nation's duty to bring Taiwan into the motherland. While emphasizing the need for peaceful reunification, the PLA undertook two very large military exercises in the area. During the second exercise the PLA launched salvos of ballistic missiles over Taiwan into the waters east of the island. These actions triggered widespread international condemnation, the Taiwanese Government held its nerve and the U.S. Government deployed sophisticated air and missile defense systems to support the island's defense. Beijing responded with intensified propaganda and political warfare operations, but their impact was modest in nearly all parts of the Indo-Pacific.

By 2031, Xi Jinping concluded that the scope for China to make further advances in the maritime Indo-Pacific was limited. In consequence, he refocused much of his external attention on China's land borders and on the potential for political, economic, and security progress in Central Asia. This focus required renewed emphasis on China's ground forces and a significant restructuring of the PLA's command and control arrangements. Xi took this opportunity to launch a reorganization of the entire PLA, prune the upper ranks, drive for consolidation and greater efficiencies, and reinforce the PLA's loyalty to the party. These reforms had the broader effect of distracting the PLA leadership from the nation's strategic and economic reversals.

In 2032–34, Xi sought to further rally the nation by launching two new international initiatives. First, China's border security forces were ordered to test Indian resolve in a key part of their disputed border, near Aksai Chin. Chinese border forces exploited bad weather to occupy three positions almost two miles into Indian-held territory. Reinforced PLA forces operated in support with armored elements maneuvering some 5 miles to the north. Indian forces responded rapidly, and a tense standoff was maintained for more than six months.

The second new Chinese initiative was to commence negotiations with the South Korean government for a broad-ranging security cooperation agreement. While Beijing and Seoul portrayed this as an initiative designed to deter Japan, the North Koreans responded angrily. In consequence, tensions along the China-DPRK border were high during 2035. However, Xi Jinping drew some comfort from the fact that the mass demonstrations on the streets of several Chinese cities were not protesting against Beijing but against perceived Japanese "militarization and fascism."

By 2035, the party leadership was forced to lower its sights. Most sectors of the Chinese economy continued to lose competitiveness, and economic growth was averaging 2.2 percent, a rate lower than that of the United States. The surging numbers of elderly and the reduced size of the workforce severely constrained budget flexibility. The PLA was no longer ascendant in the Indo-Pacific, and the reputation of the regime was severely wounded by increasingly effective Western political warfare operations. The prospects of the Chinese Communist Party regime surviving for another decade were debated with increasing frequency in the international media.

### **Scenario 3: Nationalist Drive**

General Wang Luowei, Vice-Chairman of the Central Military Commission, was worried. Travelling into Beijing for a meeting of the Central Military Commission, he received two classified reports in quick succession. They indicated that key military personnel in three provinces were openly discussing the poor performance of the national economy and of the party. From early 2022, some of these officers had been sharply critical of Xi Jinping's leadership and the major cuts to the military budget forced by the deteriorating economic situation. General Wang also knew that a few members of their families had been unfairly targeted in the party's anti-corruption campaigns. They were angry that their relatives were serving long prison sentences. Indeed, one officer's brother had even been executed. Tensions in the ranks were on the rise.

As he walked into the Central Military Commission conference room, General Wang knew that he had to mention these developments. He needed to be seen to be on the front foot in nipping such dissent in the bud. And so, when he had an opportunity to speak, he detailed his concern about some of the debates that had occurred on military bases in recent weeks and indicated that he was launching an intensive inquiry and disciplinary process in order to pull the dissenters into line.

Xi Jinping responded forcefully, shouting that any dissent should be punished severely and without any delay. He insisted that the ideological stances of all officers in the PLA be investigated as a matter of priority and that any "deviants" be tried and punished severely. He ordered a detailed progress report every week.

In the period that followed, Xi's public and internal presentations emphasized the "cultural and ideological struggle" to root out foreign influences and threats to the party and the nation. The social credit system and other national surveillance mechanisms identified thousands of suspects each day. The Commission for Discipline Inspection was given additional resources to investigate and prosecute corruption, especially in the PLA, the Peoples' Armed Police, and in associated security agencies and corporations. Within a fortnight, large numbers of people were charged with serious offenses. Visible dissent virtually disappeared, but behind the scenes grievances continued to mount.

Signs of a further deterioration in the economy were obvious by early 2023. Although the official statistics claimed a GDP growth rate of 4.2 percent, nearly everyone knew that the real figure was around 2 percent. Many businesses were shedding staff, some were declaring bankruptcy, and a large number of state-owned enterprises were only kept afloat by special subsidies and the commissioning of unnecessary infrastructure, housing, and energy projects. China's debt passed 400 percent of GDP and continued to grow at a rate faster than any major economy had ever recorded outside of war.

These difficulties were exacerbated by deepening frustration in the West with the Chinese regime's continued interference in their societies, theft of intellectual property, espionage operations, and cyber penetrations. The intrusive nature of this activity was dramatized in several Congressional and Parliamentary investigations. Factual cases were also recreated in successful television programs and movies. The television mini-series called Gulag—that dramatized life in the regime's "re-education camps" in Western China—was a global hit. Western political and public opinion swung further against the Chinese regime. In consequence, the U.S. and several allies tightened technology control and visa regulations applying to Chinese entities and individuals.

In order to distract from this increasing isolation of China, the regime ramped up its political warfare and other intimidation of Taiwan and the Philippines during 2023–24. These activities further exacerbated tensions with the West.

The pressure on the regime increased several more notches in late 2024 when the U.S. President announced a series of new breakthrough military capabilities and their deployment to the Western Pacific to deter Chinese "adventurism." These new capabilities included the new Raider B-21 strategic bomber, forward deployed marine and army units equipped with hypersonic weaponry, very advanced underwater systems, and highly sophisticated combat capabilities deployed in space. The President emphasized that he was determined that the United States and its allies would retain unquestioned strategic superiority in the Indo-Pacific and that regional partners and friends could be assured of strong American and partner support were they to be attacked by "aggressive authoritarian states."

Within a fortnight, General Wang Luowei advised Xi Jinping that while China might be able to make further advances in the Western Pacific using low-level political and hybrid warfare techniques, the newly revealed U.S. and allied capabilities meant that China was unlikely to prevail in the event of a major war, especially one that lasted more than a few weeks.

Xi was not impressed by this assessment, but rather than dispute the judgements, he decided in 2025 to distract the party and relevant agencies by launching a major expansion of the Belt and Road Initiative. With great fanfare he announced a "New Global Partnership" with a particular focus on Central Asia, parts of the Middle East, Africa, and some of the smaller states in the Indian and South Pacific Oceans. The emphasis was on building advanced communications and transport infrastructures and also on providing the latest-generation of surveillance and artificial intelligence systems to assist local China-leaning regimes

to strengthen their control. At home, Xi championed these programs as evidence of China emerging as leader of a strong coalition of global states. As he liked to say: “China now has strong friends in every part of the world.”

This BRI expansion was, however, controversial at home. Many Chinese questioned why such large sums of money were being spent overseas when the economy and a majority of households were struggling at home. Leading members of the Chinese middle and upper classes were troubled by the regime’s trajectory and took advantage of the rise in offshore investments to transfer funds offshore. Capital flight rose to record levels.

Then, in 2027, Chinese food supplies were seriously disrupted when a new virulent strain of African swine fever killed nearly 80 percent of China’s pig population. Nearly simultaneously, the national wheat crop suffered heavy losses as a result of unseasonal storms. Although relevant agencies scrambled to restore adequate food supplies, their performance was patchy, with hoarding and corruption obvious in several provinces.

Xi Jinping then launched a Maoist-like program of “socialist self-sufficiency”, but this was treated with disdain in many parts of the country. By 2029, the party and its administrative organs were increasingly seen as incompetent and focused more on the needs of a small elite rather than those of the general population. Feelings were especially strong amongst the growing masses of elderly people in rural and semi-rural communities. Divisions became more apparent in the upper echelons of the party, particularly in the PLA and the People’s Armed Police.

The patience of the party elite was further shaken by the events of March 2030. A powerful earthquake struck several provinces of central and southern China. Thousands of buildings collapsed and tens of thousands, if not hundreds of thousands, of people died in the first 48 hours. This was the most serious natural disaster to confront the party since it seized power in 1949. However, worse was to come. Emergency services were overwhelmed, and most military units were unable to get past blocked roads and collapsed bridges. Many water supply systems failed. While we still don’t know how many people died of starvation or diseases in the following months, most estimates range between 2–3 million.

During the confusion of this emergency, senior military commanders met with some prominent civilian members of the party. They nearly all wished to see fundamental change. So, in the first week of April 2030, this group arranged for Xi Jinping and most of his family and close supporters to be arrested and charged with serious crimes against the party and the Chinese people.

General Wang Luwei seized control of the media and delivered a speech on national television explaining that strong steps were being taken to recover from the crisis, advising that Xi Jinping and a small number of senior officials were standing down from their posts, calling for all citizens to contribute whatever they could to assist those in need and encouraging



calm and special care for communities in remote areas. A week later serious charges of corruption were laid against Xi Jinping and nearly a hundred of his close associates.

Later that same week General Wang Luowei announced the membership of the Interim National Leadership Team that would govern the country until full services could be reestablished. He promised that when the situation was stabilized, the normal election process for all relevant offices would be restored.

In the months that followed General Wang set a new course for the country. He announced a large package of economic reforms that he labelled “China’s New Path.” In efforts to resuscitate the economy, the Renminbi was devalued, numerous regulatory changes were made to strengthen the authority of business managers, incentives were introduced for new entrepreneurs, company tax cuts were announced for the following five years, and strong incentives were unveiled for new domestic and foreign investment.

Washington and other allied capitals welcomed these reforms, and many politicians, business leaders, and commentators assumed that a new positive era was dawning between China and the West. However, in the shadow of these announcements General Wang also took steps to boost China’s defense investments and levels of military readiness.

Then, in September 2033, following a series of military exercises near Japan and the Philippines, China launched a massive cyber, missile, and air assault on Taiwan. This attack took nearly all Western capitals by surprise. The U.S. administration expressed immediate displeasure but hesitated to render substantial assistance to Taipei. Intense debates followed within and between allied capitals to determine where the balance of allied interests lay. However, within 72 hours, the PLA had captured nearly all strategic locations in Taiwan, and the Chairman of the U.S. Joint Chiefs briefed the President that unless he wished to fight a major war with the People’s Republic, few viable military options remained. In these circumstances, the United States and many of its allies imposed a range of political and economic sanctions on China, some of which were relaxed two years later.

General Wang led massive national and international celebrations to champion the reunified China. He repeatedly claimed that the Chinese Communist Party had delivered “national reunification, it had restored China’s honor and it had turned the China dream into reality.”

## **Scenario 4: Macro-Singapore**

In the week leading up to the special party congress in November 2021, Xi Jinping’s demeanor changed. For nearly three years he had been worried by the slowing pace of the Chinese economy, the increasing political and economic headwinds overseas and the noticeable drag of the aging population. Then, as he was preparing his presentation for the party congress, he was suddenly faced with a global economic crisis that posed similar challenges to the financial crisis of 2008–9. But this time Xi knew that China was not well placed to ride through unscathed.

Global economic growth had been low for more than a decade, and most national economies were still struggling to recover from the coronavirus crisis. So when serious pressures from the new economic crisis were felt, a succession of major banks defaulted in Italy, Greece, and Spain. Then it became clear that one bank in Britain, at least two major financial institutions in the United States, and one major financial institution in Canada were also in trouble. Numerous banks in the developing world were under extreme stress and markedly reduced their operations. Global corporate and investor confidence plummeted, there were runs on the banks in several countries, stock markets fell over 30 percent, and international trading activity turned down sharply.

Xi Jinping understood that given China's deep integration into the international economy his regime could be heading for a recession. Moreover, he also realized that it would be difficult to launch yet another major stimulus package with the nation's debt already approaching 400 percent of GDP. So, six days prior to the party congress he delivered a reassuring speech, appealing for calm and announcing some short-term measures to reinforce the resilience of China's major banks and stabilize the stock markets. He also ordered a further tightening of security and warned that those spreading rumors would be arrested and "held fully accountable for their actions."

Behind the scenes Xi summoned forty of the country's leading businesspeople for a closed conference to consider options for rapidly boosting the nation's economic activity and growth rate while also strengthening competitiveness. Numerous ways of liberalizing the economy and loosening bureaucratic and party constraints on economic initiative were canvassed. However, nearly all suggestions required marked changes in the party's direction and a loosening of its control of the corporate sector. Xi listened intently but left the conference perplexed.

One of Xi Jinping's senior advisors reminded him of the thrust of a research paper jointly prepared by the State Council and the World Bank in 2012 that identified the mounting structural rigidities in the Chinese economy and the kind of reforms that were needed to sustain economic growth, strengthen economic resilience, and curb excessive debt. While Xi listened to this counsel, he decided that his presentation to the party congress would emphasize four themes: the failings of the Western model of economic development; the superiority of China's mixed economic model that combined strong state-owned enterprises with private corporations; the need to reform some financial and corporate inefficiencies; and, finally, the party's determination to see China through the current global troubles and "strive to realize the next steps towards the China dream."

In following weeks numerous initiatives were taken to reinforce the security of China's major banks. New laws were also announced to reform land and property management and reduce regulatory constraints on business. However, many business leaders believed that these steps were a case of too little, too late. Behind the scenes, discussions of possible further reforms continued and, when the economic statistics released in January 2022 showed a

decline in GDP growth to less than one percent, business leaders pressed the party to do more, and quickly.

It was in the midst of this increased stress that Xi Jinping suffered a heart attack. He was stabilized quickly, but his doctors ordered complete rest for at least two months. In the meantime a three-man interim collective leadership team within the Politburo Standing Committee took the reins. The international community immediately realized that two of the three members possessed extensive business and broader economic experience. They expected rapid changes and were not disappointed.

The restructured leadership moved quickly to introduce more far-reaching economic reforms, including the institution of rigorous intellectual property rights, acceleration of the commercialization of advanced technologies, the introduction of most elements of Western accounting practice, a more liberal set of investment guidelines and a marked reduction of political influence over the judiciary. Foreign firms were also offered generous protections should they wish to invest in China.

The impact of these measures was almost immediate. The pace of economic activity rose sharply, and investment surged so strongly that when the economic statistics for the first quarter of 2022 were released, economic growth had leapt two percentage points. Xi Jinping returned to active duty in April 2022, but his personal standing was greatly diminished, and he was now seen to be the first among a broader collective leadership team, most members of which had different professional backgrounds.

The challenges of the global economic crisis were, however, far from over. One follow-on consequence was that the debts of many developing countries incurred as part of the Belt and Road Initiative were impossible to repay. Some countries renegotiated the terms and conditions and others simply halted their repayments. This experience tarnished the regime's reputation at home and abroad, and the Chinese leadership decided to wind back most Belt and Road activities and apply much tighter commercial viability rules to new proposals.

Then in December 2022, the country started to feel the full effects of a drought that had seriously damaged the wheat, rice, and other food crops during the summer months. There was an urgent need for higher food imports and as a severe winter took hold energy imports also surged. Serious hardship gripped some provinces, especially in the north and the remote west and there were many reports of people dying of starvation and of the cold. Popular protests were common with some defacing effigies of Pooh Bear, a cartoon character that many associated with Xi Jinping.

The mounting international challenges confronting the regime were underlined when the United States administration revealed the first wave of its new generation of military capabilities. Senior PLA officers were stunned by the potential of these innovations and assessed that further American and allied initiatives could render large parts of the Chinese military

system obsolete. When they advised the party leadership that the U.S. was regaining its strategic leadership in the Indo-Pacific, they were told that the economy could not afford any significant increases in military spending and they would need to make do with further internal efficiencies.

Then, in the spring of 2024, it became obvious that Xi Jinping was ailing. He had two further visits to hospital and then made some embarrassing mistakes when presenting a major party speech. On June 6, 2024 Xi Jinping announced that he was retiring immediately and that his nominated successor as Party Secretary and national President was Chu Dezhong. Chu was a 59-year-old former party leader from Shanghai who possessed considerable business and international experience. He was rapidly confirmed as Party Secretary and in his first major speech in the role he spoke at length about what he called “The new China economy.” He promised that the party would restore higher rates of economic growth, ensure a fairer distribution of wealth and guarantee a minimum standard of living and lower cost health care for the surging numbers of senior citizens.

In the months that followed Chu Dezhong announced further reforms to boost productivity and international competitiveness. Amongst these initiatives was a rigorous review of the state sector, with many state-owned enterprises being flagged for sale.

Chu Dezhong and his senior colleagues also started to talk about forging a new business and political partnership with the international community, especially with the United States and its allies. He ordered a substantial winding back of the international operations of the Ministry of State Security, the United Front Work Department and other relevant agencies and emphasized that China had no wish to interfere with other countries’ internal affairs. When he visited Washington in early 2026 he spoke of his wish to build a new trusted relationship with the West that achieved a “collegiate peaceful rise for all countries of goodwill.” The U.S. administration welcomed this new approach warmly. A set of guidelines and a number of joint projects were readily agreed.

Washington and Moscow were taken by surprise in mid-2028 when Chu Dezhong proposed that the three countries negotiate a strategic arms control agreement that would constrain and regularize all three countries’ strategic arsenals, while simultaneously suggesting a mechanism for also involving other nuclear powers in a second phase.

Then, in perhaps an even more fundamental change of direction, Chu Dezhong announced in a major speech at the United Nations General Assembly that he had authorized a regularization of the status of all Chinese ethnic minorities. He stated that it would no longer be legal in China for any person to be held in custody for more than a month unless they had been charged with a serious crime. He also said that periodic visits by international human rights delegations would be welcome in any part of the country.

By late 2029, the Chinese economy had fully recovered from the crisis of 2021–22 and was averaging 3–4 percent GDP growth annually. Meaningful steps were being taken to ensure

a more equal distribution of resources across the society, the elderly were receiving a better deal, and private enterprise was both welcomed and fostered. Indeed, in the summer of 2030 there was even some discussion about the possibility of permitting new political parties to form and contest some local and provincial elections. Commentary in the West started to suggest that China could emerge in the 2030's as a normal international partner that the West could trust for the long term.



## CHAPTER 4

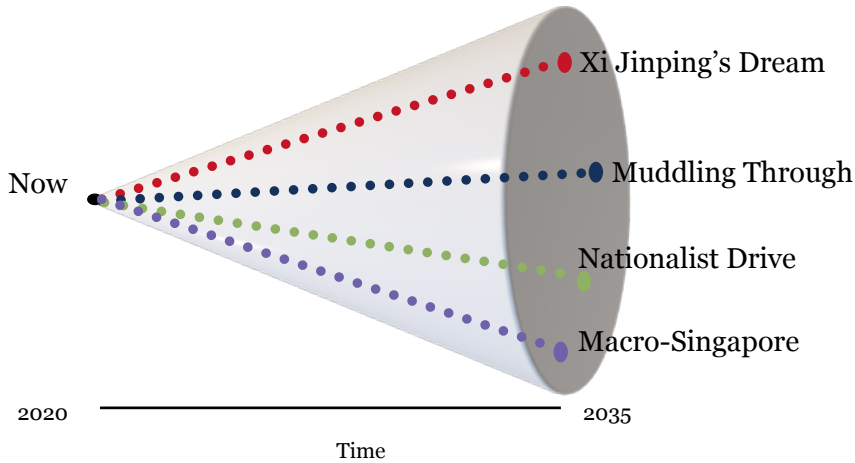
# Plotting China's Scenario Trajectories to Sharpen Security Planning for 2020-2035

The four scenarios described in Chapter 3 envisage distinctly different trajectories for China to 2035. In each case the scenarios pass through a series of gateways or lead indicators in order to arrive at the final scenario outcome. Figure 9 illustrates in a simplified manner the progression of lead indicators over the 15-year period. The primary point to be made here is that if, during 2020–2023, four of the lead indicators for Xi Jinping's Dream light up but no other lead indicators are apparent, it would be reasonable for defense planners to start shaping investments optimized for the situation where Xi Jinping's Dream is achieved in 2035. Then if, in 2024–2026, six lead indicators leading to Xi Jinping's Dream are alight but they are joined by four lead indicators leading to Muddling Through, it would be reasonable to adjust the trajectory of defense planning and investments so that they are optimized for a combination of those two scenarios in 2035.

Indicative sets of lead indicators are listed for each scenario in Table 1. These lists are only illustrative. Were this methodology to be applied in practice, more detailed analysis of each scenario could be expected to identify a larger number of credible lead indicators that were unique to each scenario trajectory. Tracking those lead indicators that are identified in the real world would generate greater confidence in judgments about China's future.

Please also note that while there is some logic to the general order of the identified lead indicators listed for each scenario, the order in which they occur in real life is likely to be different. The most important judgements for analysts to make are whether there are more indicators lit for one, or maybe two, scenarios than for the others.

FIGURE 9: ILLUSTRATIVE LEAD INDICATOR TRAJECTORIES TO 2035



A further refinement would be to grade each lead indicator as it is identified as occurring in real life at several—possibly 4 or 5—levels of intensity. So, for instance, if there are indications of party dissent, it would be useful for relevant intelligence analysts to rate the dissent as at level 1 or 2, rather than 4 or 5 or vice versa. In some briefings these varying levels of intensity could be displayed by colors featuring different levels of brightness.

TABLE 1: ILLUSTRATIVE LEAD INDICATORS FOR REPRESENTATIVE SCENARIOS

Xi Jinping's Dream	Muddling Through	Nationalist Drive	Macro-Singapore
Sees need for reform	Economic growth slows	Xi tightens Party control	Economic reversals
Partners with business	Some domestic dissent	Cultural Struggle launch	Run on banks
Incentivization steps	Xi tightens discipline	Anti-corrupt show trials	Western decoupling
Investment surge	New stimulus measures	Econ growth 1-2%.	Xi survives health scare
Tech breakthroughs	BRI still a priority	US tightens tech controls	Collective leadership
Exports boom	Debt to >400% of GDP	PRC spy ops. revealed	Competitiveness decline
U.S. in disarray	Growth falls to 2-3%	Chinese tech failures	Investment flight
Ideological spin	US + allies counter political warfare	Anti- Taiwan effort rises	Xi tightens controls
Economic growth rises	US tests 3rd offset	US shows 3rd Offset	Major earthquake
Starts to cut debt	Xi urges family growth	Drought and recession	Some BRI debts unpaid
U.S. distracted elsewhere	Manila supports U.S.	BRI aimed at South East Asia & Africa	U.S. 3rd Offset revealed
Banking reforms	U.S. boosts West Pacific forces	Rise of domestic dissent	Econ. growth 1-3%



Political warfare pushed	Xi ramps up political and hybrid warfare	Capital & human flight	Xi Jinping retires
U.S. Third Offset fizzles	Investment slumps	Xi's new 'global alliance'	Deep economic reform push
Charm offensives o'seas	PLA trumped by 3rd offset	Authoritarian summit	Bank & business reform
Clash with Vietnam	Technology failures & recession	New PLA bases o'seas	Western accounting etc.
Banking reforms	Capital and skills flight	PLAAF stealth bomber	Reduced Party role
New PLA bases overseas	Ideological tightening	West ramps up political warfare	New relations with West
Pressure on Taiwan	Authoritarian alliance	UN blasts human rights	Party cuts political warfare overseas
Anti-access area-denial bubbles in Indian Ocean	Tighter U.S. technology controls	Competitiveness decline	New cooperative era with West
Treaty with Russia	West limits China travel	Banking crisis	Strong domestic focus
Xi unchallengeable	New dissent in Party	Public health crises	Defense budget flat
China 2025 goals won	PLA probes U.S. defenses	Allies ramp-up political warfare	New joint ventures with the West
PLA bases in SWP	US defends Philippine Exclusive Econ. Zone	PLA standing force in Indian Ocean	Cut distant PLA ops
CCP model sold o'seas	Nationalist youth corps	Rise in Party debates	New tech successes
Record PLAN exercises	Taiwan defiant	Nationalist propaganda	Rise in corp. profits
Taiwan wobbles	'Peace Fleet' tours	Military/Party coup	BRI wound-back
PRC space success	State Owned Enterprise troubles mount	Econ. & ideology reform	Arms control with U.S.
Taiwan collapses	Counter-corrupt push	PLA budget rises	Normalizes minorities
PLA bases on Taiwan	PLA budget cut	Taiwan assault success	Econ. growth 3-4%
China 'dream' in reach	Border clashes	PLA bases on Taiwan	Other parties allowed

## Developing Optimal Sets of Defense Decisions for 2035

As mentioned earlier in this report, a primary advantage of this methodology is that by envisaging a clearly defined set of representative scenarios, a firm foundation is provided for making logical capability choices in a progressive manner through the fifteen years of the planning window. At a very early stage in the process officials can analyze in some depth the most important strategies, operational concepts and capabilities that should be put in place if China looks to be heading for one or other scenario outcome in 2035. For instance, analysts could consider from the outset the operating concepts and capabilities that would deserve priority for acquisition by 2035 if China looks to be heading towards Nationalist Drive or Macro-Singapore. Many analytical techniques, including gaming and some competitive exercises, could be used to derive well-considered sets of defense investments.

It is beyond the scope of this paper to identify specific concepts and capabilities that would, or would not, be highlighted as optimal capability mixes for the United States and its allies to acquire for each scenario. However, some key features of what is likely to emerge do warrant comment.

### **Key Capability Categories**

There are likely to be two main categories of capabilities that are identified in these analyses: those capabilities that are common to all scenarios and those capabilities which are specific to one or more scenarios but not to all.

Most common capability requirements would possess three characteristics. First, they would be critical for the performance of key allied functions in all scenarios. Second, the timeframes for the acquisition of common capabilities would mostly be long. And third, in many cases the service lives of these foundational and mostly expensive systems would be even longer. Capabilities that are common could be expected to include all of the following, though they would not necessarily be required in identical numbers:

- Advanced strategic analytical staffs.
- High quality intelligence collection and analytical capabilities.
- Military bases and logistic support facilities.
- Key communications and cyber capabilities.
- Essential space-based reconnaissance, navigation, weather and other systems.
- Major air, sea, and land sensor and weapons platforms.
- A mix of weapons and weapons stocks.
- Advanced industrial capabilities that are agile, fast-moving, and capable of meeting new requirements in a timely way.
- Advanced education and training systems for military and civilian personnel.

Scenario-specific capabilities would supplement the common capabilities to ensure the delivery of the tailored special effects that would be priorities in each scenario. These specially chosen capabilities would often have a disproportionate impact on theater outcomes in the circumstances of each future. Scenario-specific capabilities would normally be characterized by the following features:

- They would be driven by the needs of the latest strategic and operational concepts.
- They would be developed and refined via processes of operational experimentation and testing.

- Many would employ new technologies or innovative mixes of technology used in novel ways.
- Sensors, weapons and modest-sized platforms would feature more prominently than large and expensive platforms.
- Advanced industry production and support capabilities would play a key role in providing capabilities to adapt rapidly to changing needs and also surge the production of priority high-usage weapons and other systems as may be required.

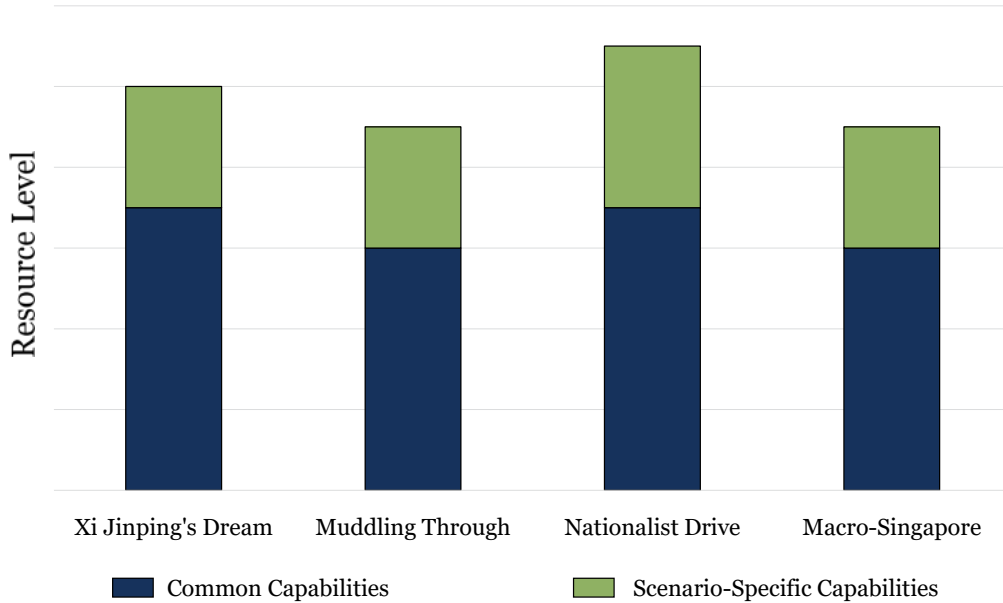
The differing mixes of common and scenario-specific capabilities that might emerge from such analyses are portrayed in an illustrative manner in Figure 10. Please note that while each scenario would require many common capabilities, they are unlikely to need them in the same quantities. Second, the scenario-specific capabilities would not only be different in nature, but they would also differ in number and scale. In this illustration, it is assumed that the Nationalist Drive scenario would require the highest number of scenario-specific capabilities and also, probably, the highest total capability budget over the 15 years.

### **Programing Defense Investments**

This methodology permits design and acquisition processes for some of the common capabilities to commence as soon as they have been identified and agreed, presumably in the first year of the process. Then, once lead indicators are detected towards one or other of the scenarios, planning could commence to acquire some of the relevant scenario-specific capabilities as well.

The sequence of these capability acquisitions would be determined by several factors. They would include the mix and age of the capabilities already held in the extant force, the need to maintain operational effectiveness to meet emerging contingencies as the force transforms itself, and the scale of budget allocations that governments authorize. However, the close integration of scenario lead indicators with the selection of capability mixes and acquisition timing should ensure that the total force is optimized to meet the demands of the type of China that eventuates in 15 years' time. It should also help ensure that the force that evolves on the way to 2035 is more sharply focused on the most important priorities and is suitably equipped for any crisis that occurs along the way.

**FIGURE 10: ALLIED CAPABILITY MIXES FOR ALTERNATIVE SCENARIOS**



### Repeating the Process

As mentioned earlier in this report, this proposed type of scenario-driven planning and capability development methodology is not intended to be a set and forget approach. The scenarios and the accompanying lead indicator and monitoring systems developed in 2020–22 should ensure that initial defense capability decisions are well-matched to China's trajectory. An established system of this type should be adequate to guide priorities for defense investment for the first 3–5 years.

However, as time passes, some new dimensions of Chinese development would likely become apparent. The close allies can also be expected to test new operational concepts and technologies, some of which may offer unexpected advantages. The economic, social, and political circumstances of some regional actors may also change in unanticipated ways.

The best way of accommodating these national and international dynamics would be to repeat the process of scenario research and development at 3–5 year intervals. This might result in one or more scenarios being retained but others might be replaced. A revised scenario set may better represent the totality of the evolving scenario space and the updated lists of lead indicators would likely provide greater clarity in assessing China's ongoing trajectory. The revised total system should also permit some refinement of capability priorities going forward and reinforce the confidence with which major investment decisions can be taken.

## Possible Game-Changing Capabilities

The methodology described in this report is driven primarily by carefully calibrated continuous assessments of China's trajectory. The primary purpose of this approach is to ensure that so far as is possible, the U.S., its allies and security partners are fully prepared to deter and, if necessary, defeat China in 2035 and in the years that follow, no matter how China develops in the interim. Its success is not dependent on doing the impossible—accurately predicting the future 15 years hence. The integrated analytical, planning, and acquisition processes are designed to ensure that by 2035 allied defenses are fully fit-for-purpose and will remain so.

There is, however, a further dimension of some importance. The concentration of the highest grade defense minds in repeated and, potentially, competitive analytical processes may result in the identification of one or more strategic or operational concepts that could change the game in the way that the assault breaker and the follow-on forces attack concepts changed the deterrence and defensive balance in Europe in the 1980s.<sup>43</sup> Innovative possibilities such as these deserve special attention because if experiments and tests verify that they would be effective, they may become strong drivers of the choices for development and acquisition of both common defense capabilities and those that are scenario specific.

While offset and other potential game-changing concepts should be encouraged and deserve careful consideration they would still need to be assessed for their capability to generate high levels of strategic or operational leverage within the priority scenarios. Should these analyses, and potentially field experiments, show that they are truly transformational, they would rightly become primary drivers of capability plans and of acquisition budgets. Indeed, they may become potential war-winners.

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43 For an explanation of the history of 'Offset Strategies' such as Assault Breaker see: Work and Grant, *Beating the Americans at their Own Game*, pp. 2-3.



## CHAPTER 5

# Conclusions and Recommendations

### **Appreciating the Challenge**

The drivers for reform of the Western allies' strategic assessment and capability development systems are not only the need for improved efficiency, effectiveness, and reduced costs. There is now a very strong strategic imperative. In the Indo-Pacific, the United States and its allies are confronted by a highly capable major power rival that not only possesses substantial defense and broader national security systems but is employing these capabilities in highly assertive ways. Moreover, China's future trajectory is very uncertain. There is a strong possibility, maybe a probability, of major changes in China and in the broader Indo-Pacific region before 2035.

In consequence, the processes of U.S. and allied defense planning for the Indo-Pacific inherited from earlier eras are sub-optimal. Current processes rely on the periodic production of major assessments of the future that attempt to deliver what is practically impossible, describing accurately the medium-to-long-term future. The timeframes for the confident prediction of the most important variables are simply too short to provide clarity for decision-makers choosing defense capabilities for operations 15 years or more into the future.

The production of such major assessments at three- to eight-year intervals also tends to lock decision-makers into a set of judgments that may or may not retain validity until the next National Defense Strategy, Defense White Paper, or set of National Defense Guidelines is produced. This process lacks responsiveness and the sort of flexibility that is required when many strategic dimensions are moving constantly, sometimes in unexpected directions, across the region.

This report argues that when selecting allied defense capabilities for the Indo-Pacific for the medium-to-long term superior choices can be made in a more timely way by using a proven scenario-based methodology.

One major advantage of this approach is that as soon as the representative scenarios are defined, joint force teams can devise and test the best mix of strategies, operational concepts and physical capabilities that could be acquired within relevant budget parameters for each scenario. This could be done much earlier than would otherwise be possible and various mechanisms could be employed to encourage innovative approaches.

This type of evidence-based planning system should produce superior results in a more timely fashion and deliver more efficient and effective investment outcomes. Ultimately, it should deliver mixes of combat capabilities that are close to optimal, no matter what the strategic future looks like fifteen or more years into the future. It should significantly reduce the risks of being taken by surprise; it should provide early warning of significant shifts in China's and the broader region's strategic trajectory; and it should also foster the development of flexible capabilities to deal with unexpected demands that arise in the interim.

The secondary benefits of this methodology are also worth noting. Early identification of potential scenarios in the priority theatre should help ensure that all planning staffs are focused primarily on 'the main game' and not distracted elsewhere. Strategic, operational, and capability planning skills should be enhanced, with some personnel able to develop exceptional levels of expertise by making their careers in the field.

The logical progression of this type of planning should also improve the types of engagement that are possible with political leaders as well as with relevant congressional and parliamentary committees. Defense capability decisions are sometimes seen by political leaders as being ad hoc and uncoordinated. However, using the proposed process, defense planning and capability choices should be seen as being far more convincing than at present and they could potentially contribute to the development of significantly improved relationships between defense officials and relevant legislators.

## Conclusions

The primary conclusions of this report are:

1. China's current strategic situation is characterized by multiple instabilities and uncertainties. While it is possible that China will continue on its current trajectory till 2035, it is more likely that there will be significant departures. The United States and its close allies need to be prepared for major changes and to have thought through how best to manage such situations well in advance.
2. The assumption made by many in the West that the rapid rate of economic growth that China has experienced during the last three decades will be maintained during the



2020s is possible but very unlikely. China's rate of GDP growth has already halved since 2007 and continues to slow. Productivity levels are also falling along with international competitiveness in many sectors. National debt is very high and the budgetary burdens of a rapidly aging population are increasing. In the face of these challenges as well as biosecurity and other pressures Xi Jinping's instinct is to clamp down harder on information flows, further tighten party control, increase the centralization of power, and work hard to maintain a sense of normality. Important consequences of this approach are to further constrain economic dynamism and increase the unpredictability of China's trajectory to 2035.

3. The defense of Taiwan and the integrity of the U.S. and allied positions on the first island chain in the Western Pacific will continue to be inseparable and mutually reinforcing. Measures to harden the frontline states, including Japan, Taiwan, and the Philippines will not only complicate the PLA's campaigns plans, but also compel Beijing to stay fixated on local contingencies at the expense of its extra-regional ambitions.
4. The actions or inactions of the United States and its allies will have a substantial influence on the Chinese regime's behavior during coming decades, particularly China's actions beyond its borders. There are strong incentives for the Western allies and their partners to consult more extensively on the challenges posed by the Chinese Communist regime and the most appropriate strategies and operational plans.
5. The habit of the Western allies of basing their defense planning and priorities on periodic strategic reviews which are maintained as guide-posts for several years is inadequate for the dynamic situation in the Indo-Pacific. Confident security and defense planning require a different approach.
6. The Western allies need a planning system that can accommodate marked changes in China's trajectory. The need is for a mechanism that can detect and assess strategic changes in China promptly and link them directly to rapidly-paced Western counter-measures. Devising and implementing such an alert and agile system is a primary 'front-end' challenge for allied defense and security planning.
7. By defining a set of representative scenarios, a firm foundation can be provided for making logical capability choices in a progressive manner through the fifteen years of a defense planning window. The scenarios and the accompanying lead indicator and monitoring systems should ensure that initial defense capability decisions are well-matched to China's trajectory. At an early stage in the process officials can analyze in some depth the most important capabilities and operational concepts that should be put in place if China looks to be heading for a particular scenario outcome in 2035.
8. Six key variables will largely determine the shape of China's strategic future:
  - The power, performance, and durability of the Chinese Communist Party regime.

- The economic, technological, and corporate progress of the country.
  - The extent to which China's modernized military is employed aggressively beyond the nation's borders.
  - The level of international cooperation or resistance that confronts China.
  - Whether the Chinese regime seeks to rally the country by adopting highly nationalistic rhetoric and international stances.
  - The extent to which the Chinese regime moves to expand its international political, economic and military footprint in key parts of the Indo-Pacific region and beyond.
9. This research generated four consolidated scenarios that, as a set, effectively represent China's future scenario space:
- Xi Jinping's Dream
  - Muddling Through
  - Nationalist Drive
  - Macro-Singapore
10. The type of scenario-driven planning and capability development methodology described in this report is not intended to be a set and forget approach. A process of this type should be adequate to guide priorities for defense investment for the first three to five years and should then be repeated.
11. There would be value in using competitive analytical processes to identify one or more strategic or operational concepts that could change the game in the Indo-Pacific in the same way that the assault breaker and the follow-on forces attack concepts changed the deterrence and defensive balance in Europe in the 1980s. Innovative possibilities such as these deserve special attention because if experiments and tests verify that they would be effective, they may become strong drivers of the choices for development and acquisition across all credible scenarios.
12. Almost all credible futures for China pose challenges for the United States and its allies that are multi-disciplinary. Effective Western actions to influence, coerce or counter Beijing will require coordinated actions across government, across nations and, in many cases, across the broader Western alliance. Activating, energizing, directing and coordinating such complex operations will be a major challenge for all parties, especially for the United States and its close allies. It will, however, be essential for success. Current mechanisms for consultation, coordinated planning and combined action may be suboptimal for the current situation and warrant careful review.

13. If the United States and its close Indo-Pacific allies closely coordinate their planning and operations they have the potential to actively shape the future and, in many situations, strongly influence Beijing's decision-making and medium- and longer-term trajectory. Options for shaping and channeling Beijing's behavior deserve far greater research and policy attention.
14. One of the biggest constraints on achieving success in these and related reforms may be the difficulties in adapting personnel cultures, bureaucratic systems and staff skill sets. These issues will need to be accorded high priority. Revised personnel, management, and operational systems will need to be developed and implemented in close partnership with the modernized systems for selecting, designing, testing and manufacturing new hardware and software. Exceptional leadership will be required.

## Recommendations

The primary recommendations of this report are:

1. The Western allies should give greater consideration to the prospect that China will depart from its current trajectory in coming years. The potential implications of these anticipated shifts in one or more domains could have profound strategic consequences. The allies should strive to develop a deeper understanding of potential changes and consider those they wish to encourage and those they wish to thwart.
2. In order to deal with the multi-disciplinary challenges that are likely to be posed by the Chinese regime in coming decades, the Western allies and their security partners should critically review their current systems and processes for strategic assessment, developing strategy, and planning and managing rapidly-paced operations across multiple agencies and non-government entities.
3. Allied defense and security organizations should avoid the use of single-scenario analyses when considering major defense investments for future operations in the Indo-Pacific theater.
4. Allied defense organizations should trial a process of scenario development and continuous lead indicator tracking. This process should provide clear guidance on the region's security trajectory; permit early consideration of alternative strategy, operational concept, and capability mixes; and facilitate timely decision-making.
5. The United States and its allies should use small competitive teams to sharpen the quality and timeliness of some strategic assessment and capability development processes.
6. The Western allies and their partners should consult more extensively on the challenges posed by the Chinese Communist regime and the most appropriate strategies and operational plans to deter and, if necessary, confront Beijing. Current mechanisms

for consultation, coordinated planning, and combined action may be suboptimal for the current situation and warrant careful review.

7. In working to institute such reforms, an early priority should be a substantial strengthening of personnel cultures, organizational systems, and multi-disciplinary skill-sets. Exceptional leadership will be needed.
8. There would be value in using competitive analytical processes to identify one or more strategic or operational concepts that could “change the game” in the Indo-Pacific in the same way that the assault breaker and follow-on forces attack concepts changed the deterrence and defensive balance in Europe in the 1980s. Innovative possibilities such as these deserve special attention.
9. The United States and its allies should consider the potential impact of the reforms proposed in this report to strengthen Western resilience and endurance, particularly in the event of an extended period of tension or conflict.

# Appendixes

**APPENDIX A:** Why Predicting, and Planning for, a Single Future for China is Unwise

Jack Bianchi

**APPENDIX B:** The Practicalities of Scenario Development

Ross Babbage

**APPENDIX C:** Primary Scenarios for China's Political Leadership and Political System in 2035

Aaron Friedberg and Nadège Rolland

**APPENDIX D:** China's Economic Futures in 2035

Julian Snelder

**APPENDIX E:** Scenarios for China's Military in 2035

Toshi Yoshihara

**APPENDIX F:** Primary Geo-economic and Geo-strategic Scenarios for 2035

Aaron Friedberg and Nadège Rolland



## APPENDIX A

# Why Predicting, and Planning for, a Single Future for China is Unwise

**Jack Bianchi**

Predicting the future with certainty is impossible. Experts have developed various predictive methodologies, yet these methods remain hampered by the future's inherent opacity and can usually provide only glimpses of coming events. Making strategically useful judgements about China's future is especially challenging because of the vast number of variables and uncertainties involved. While many experts and groups of experts have applied themselves to this task in the post-Mao era, the track record is poor, and attempting to predict China's future for any but the short-term future is risky. This has serious implications for allied policymakers who are required to make decisions today that will shape their country's choices, capabilities, and outcomes vis-à-vis China for decades to come.

## **An Overview of Predictive Methods**

Rational prediction is based on stable patterns derived from available data from the past and present. What all forecasting methods therefore share is that they are one or other form of "pattern fitting," in which the future is presumed to develop in a certain way according to existing information about the past.<sup>44</sup> Yet forecasting's foundation on analysis of existing data opens the enterprise to numerous difficulties, as there are limits both to what we know

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44 Nicholas Rescher, *Predicting the Future: An Introduction to the Theory of Forecasting* (Albany, NY: State University of New York Press, 1998), 86.

and to what we are capable of knowing. Uncertainty, chance, chaos, and human choice make prediction incredibly difficult.<sup>45</sup>

Analysts currently use several predictive methods to forecast the future and, borrowing Nicholas Rescher’s framework, these methods fall into two main categories: “Formalized/Inferential” and “Unformalized/Judgmental.” Formalized/inferential methods are rooted in “rule-specified modes of reasoning,” with rules derived primarily from empirically established relationships.<sup>46</sup> The primary unformalized/judgmental method is expert judgment. These formal and informal methods are not mutually exclusive and forecasts usually increase their accuracy by combining a variety of methods. Specific shortcomings of each of these forecasting methods, beyond the general challenges listed above, are described below.

### Formal Forecasting Methods

There is a great variety of formal forecasting methods, including trend projection, curve fitting, cycle analysis, correlation analysis, historical analogy, theory derivation, and formal modeling.<sup>47</sup>

In *trend projection*, existing trends are simply carried forward into the future, but this is usually an overly simplistic method, especially over the long term. Present trends rarely continue indefinitely and this type of analysis ignores potential changes in the underlying drivers of these trends. *Curve fitting* is similar to trend projection except that instead of linear projections based on present rates of change, current trends are fitted—particularly through statistical analysis—to nonlinear curves that may better depict future developments.<sup>48</sup> For example, many forecasts of China’s economic growth and related market variables now apply an S-shaped curve, indicating an expected slowing growth rate after recent decades of rapid growth.<sup>49</sup> Despite utilizing complex statistical tools, these approaches still develop forecasts by using historical data relevant to the particular variable of interest, which may not necessarily be useful for projecting that variable’s future behavior. The statistical methods are also still subject to human bias in selecting and analyzing the data.

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45 Rescher, 133-156. See also: Nassim Nicolas Taleb, *The Black Swan: The Impact of the Highly Improbable*, 2nd ed. (New York: Random House, 2010), xxi-xxxiii.

46 Rescher, 85-112.

47 Rescher identifies several of these methods and his comprehensive treatment of formal predictive methods includes an extensive list of formal predictive methods and their variants. Rescher, 97-112.

48 Rescher, 99.

49 For examples, see: Andrew Erickson and Gabe Collins, “China’s S-Shaped Threat,” *The Diplomat*, September 6, 2011, available at <https://thediplomat.com/2011/09/chinas-s-shaped-threat/> and Tian Wu, Hongmei Zhao, and Xunmin Ou, “Vehicle Ownership Analysis Based on GDP per Capita in China: 1963–2050,” *Sustainability* 2014, 6, 4877-4899, available at <https://www.mdpi.com/2071-1050/6/8/4877>.



For variables that follow repetitive behavior patterns, such as for certain economic or financial market variables, *cycle analysis* can be used for forecasting.<sup>50</sup> Yet determining the current cycle's full length and one's position within it is usually very difficult and any projection is therefore full of uncertainty.<sup>51</sup> *Historical analogy* can be used to compare a past episode—in terms of narrative, structures, or processes—with a contemporary one.<sup>52</sup> But the drawback here is that no two events are identical and the two events may not actually be sufficiently similar to make useful predictions.<sup>53</sup> History does not always repeat itself and even similar preconditions may lead to different outcomes.

*Correlation analysis* can be used for forecasting if, historically, a specific type of event has preceded a certain second event. But the level of certainty in this type of forecast may depend on whether the connection between the two events is an explainable causal relationship. Basing forecasts on correlated events with an unexplained causal relationship—a particular problem for emerging artificial intelligence-based analysis—may be dangerous since changes could occur in the underlying causal factors with analysts caught unaware.<sup>54</sup>

*Theory derivation*, in the social sciences, uses inductive theories developed from the observance of patterns in historical events to forecast the future. International relations theories—primarily realism, liberalism, and constructivism—have been developed over the last century to explain major geopolitical events, such as the outbreak of the First World War. These theories may provide a useful framework for understanding how states interact, but when they are used to predict future interactions among states, their track record is poor. Social science theories are simplifications of complex evolving phenomena, and uncertainty, chance, chaos, and human choice play too great a role in these events for theory to be a definitive guide.

*Modeling* can be used to recreate, either physically or symbolically, the processes leading to a specific event. Computer modeling, in which algorithms forecast an outcome based on a variety of data inputs, is now frequently used and, in the social sciences, has been very accurate for some types of economic forecasting. Yet computer models rely on the availability of relevant data and the ability of the model's algorithms to reflect the complexity of actual

50 Rescher, 100-101.

51 This difficulty is exemplified by the professional field of investment fund managers, which on average fails to match market performance. Terry Smith, "Market timing: Don't Try This at Home," *Financial Times*, March 1, 2013, available at <https://www.ft.com/content/74457b4c-801f-11e2-adbd-00144feabdco>.

52 Rescher 101-102.

53 Philip Tetlock's recent research on historical analogy-based prediction concludes that events should be seen as points along a "uniqueness continuum." His empirical findings indicate greater predictive accuracy when comparing single events to classes of historical events, as opposed to considering every event as wholly unique. See Philip E. Tetlock, *Expert Political Judgment: How Good Is It? How Can We Know?* 2nd ed. (Princeton, NJ: Princeton University Press, 2017), pp. xxx-xxxii. For additional guidance on the applicability of historical analogy, see the classic text Richard E. Neustadt and Ernest R. May, *Thinking in Time: The Uses of History for Decision-Makers* (New York: The Free Press, 1986).

54 Rescher, 102-104.

interactions. As such, these forecasting models still experience great challenges in quantitative social science fields, such as economics, let alone the more qualitative social sciences, such as political science and international relations.<sup>55</sup>

### Informal Forecasting Methods

In contrast to the numerous formal methods discussed above, the primary informal method is expert judgment. Expert judgment is valuable because informed experts grasp the complexities of historical and present events in a given context and are therefore presumed to have greater insight on a particular issue or domain than non-experts. When more structured, scientific methods of prediction are not suited for a given topic, expert opinion is usually the only remaining forecasting method available and, hence, it is frequently used in the social sciences. A history of accurate prediction is usually required to consider an expert credible, though even a history of success is still no guarantee of future success in the same or a different domain.<sup>56</sup> The form of expert judgment can range from individual expert or expert group opinion, to averaging expert opinion, to scanning of expert views and actions, to more sophisticated consensus-building methods.<sup>57</sup>

The main problem with *individual expert opinion* is that it is biased, as individuals inherently base their predictions on their own unique knowledge, experience, and modes of thought.<sup>58</sup> Personal bias, combined with the inaccuracy and incompleteness of existing information, the complexities of real-world interactions among contradictory forces, and the random interjection of unforeseen events, often results in individual expert forecasts being incorrect, especially over the long term.<sup>59</sup> A particular problem for policymakers who rely on expert prediction is that equally respected experts often disagree, arriving at mutually incompatible predictions, leaving the policymaker confused about which prediction, if any, to use as a basis for decision making.<sup>60</sup>

To reduce individual bias and increase the knowledge and experience used in creating a forecast, *expert groups* can be tasked with forecasting. Group judgment offers advantages over individual judgment, mainly resulting from the ability of the group to aggregate diverse

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55 Rescher, 106-110. For examples on the challenges and applicability of modeling in security studies, see Stephen M. Walt, "Rigor or Rigor Mortis?," *International Security* 23, no. 4, Spring 1999, pp. 5-48; Robert Powell, "The Modeling Enterprise and Security Studies," *International Security* 24, no. 2, Fall 1999, pp. 97-106; and Paul K. Davis, Angela O'Mahony, "Special Issue: Representing Social Science in National-Security-Related Modeling and Simulation," *Journal of Defense Modeling and Simulation* 14, no. 1, January 2017, pp. 3-5.

56 Rescher 88-90.

57 Scenario construction is not a method of prediction since it is a creative exercise that produces a range of possible futures, rather than predicting one particular future.

58 Rescher 88-90. See also: Daniel Kahneman, *Thinking, Fast and Slow* (New York: Farrar, Straus, and Giroux, 2013).

59 Tetlock found that even skilled forecasters were little better than chance at predicting events more than five years ahead. For empirical evidence on how time horizons affect expert forecasts, see: Tetlock, 67-86.

60 For an example on forecasting the Soviet Union's future in the mid-1980s, see: Tetlock, pp. xi-xvi.

information sources and debate multiple unique viewpoints, ultimately producing a decision based on the most convincing views.<sup>61</sup> In ideal circumstances, groups have thus been found to be more accurate at predicting the future than individuals.<sup>62</sup> But groups face a number of unique challenges in forecasting. According to Cass R. Sunstein and Reid Hastie, group errors result from:

1. “Informational signals,” information shared by group members that affects the thinking of other members, and
2. “Reputational pressures,” the risk of reputational loss by voicing or adhering to one’s perceived minority views.

These two factors lead to problems including amplification of group biases, cascading group member responses that support initially expressed viewpoints, polarization around viewpoints more severe than initially held, and disregard of unique information in favor of commonly shared information.<sup>63</sup>

Groups are empirically better at prediction when they can overcome these challenges, as shown by Philip Tetlock’s research on forecasting. Individuals who are open to consulting a variety of data sources and to adjusting their conclusions based on new information—people who Tetlock refers to as “foxes”—are better at prediction than rigid thinkers—labeled as “hedgehogs”—who stubbornly stick to their existing reference points and explanatory models.<sup>64</sup> A large-scale forecasting tournament sponsored by the U.S. Intelligence Advanced Research Projects Agency, in which Tetlock’s teams of diverse, open-minded, and pragmatic forecasters outperformed their peers, further confirms this conclusion.<sup>65</sup> Yet, despite these impressive results in increasing predictive accuracy, certainty in predicting the future over the medium and long term is still elusive, even for the most talented forecasters.

To attempt to eliminate individual bias and the impact of group dynamics, *averaging individual expert judgment* can be performed to reach a singular consensus. This method is feasible for binary (e.g. “yes/no”) or quantitative questions. The average answer from even a crowd of non-experts has been shown to outperform individual expert estimates under certain conditions,<sup>66</sup> but this is a fundamentally unsophisticated method with its own

61 Cass R. Sunstein and Reid Hastie, “Making Dumb Groups Smarter,” *Harvard Business Review* 92, no. 12, December 2014. See also James Surowiecki, *The Wisdom of Crowds* (New York: Anchor Books, 2005) and Philip E. Tetlock and Dan Gardner, *Superforecasting: The Art and Science of Prediction* (New York: Broadway Books, 2015), 197-211.

62 Walter Frick, “What Research Tells Us About Making Accurate Predictions,” *Harvard Business Review*, February 2, 2015, available at <https://hbr.org/2015/02/what-research-tells-us-about-making-accurate-predictions>.

63 Sunstein and Hastie, “Making Dumb Groups Smarter,” *Harvard Business Review*, December 2014, <https://hbr.org/2014/12/making-dumb-groups-smarter>

64 Tetlock, 2017, 67-120.

65 Tetlock and Gardner, 191-211.

66 Surowiecki, xi-xiii.

shortcomings. This method simply cannot be used for many complex, non-quantitative questions and, even when it can be used, the average answer is not necessarily better than most of the individual estimates.<sup>67</sup> This method also ignores uncertainty, as single predictions are made without accounting for the range of possible future outcomes. Averaging seems best suited to fields where it has been historically more successful than individual opinion in predicting outcomes, such as in certain economic forecasts, and even then its accuracy should not be overestimated.<sup>68</sup>

More advanced than simple averaging, *environmental scanning analysis* can be used to research a particular topic by performing a broad survey of the relevant domain, including through interviews and workshops with experts, a literature review of academic and other publications, systematized internet searches, and the tracking of expert insights and conferences.<sup>69</sup> By broadly canvassing these data sources, with a strong reliance on expert views and actions, researchers aim to rapidly acquire and analyze information that can indicate the future direction of a given field. As this research is conducted, the scope of the effort can be narrowed so that only the most important indicators are followed.<sup>70</sup> Through this encompassing research effort, the bias of individual experts may be diluted, though the analysis will still be impacted by the collective bias of the experts and of the bias of researchers conducting the scanning. Moreover, while this method is essentially an extensive literature review process, the separate analytical methodology used by the researchers to process and analyze the resulting information is of critical importance and is not a standardized component of this research method. Finally, this research method can only progress as far as the existing expert discourse has evolved on a given topic.

Finally, in the most advanced form, expert judgement can be used in consensus-building methods for forecasting. In a consensus-building approach, such as the *Delphi Method*, experts answer sequential questionnaires designed to build consensus among the participants over time.<sup>71</sup> The respondents do not meet in person in order to avoid group dynamic factors that could taint the method's results. After experts answer the first questionnaire, the coordinators compile the answers and send back the anonymized statistical results of the first questionnaire, including representative arguments for each of the major positions. Together with the results, a second questionnaire asks the experts whether they agree with the majority on each of the first survey's questions. The experts are required to justify their answers if they disagree with the majority, which itself inclines the experts toward accepting

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67 Rescher, 91-92.

68 Rescher, 91-92.

69 This method is also referred to as "futures scanning systems," "early warning systems," "futures intelligence systems," and "collective intelligence." Theodore J. Gordon and Jerome C. Glenn, "Environmental Scanning," in Theodore J. Gordon and Jerome C. Glenn, eds., *Futures Research Methodology Version 3.0*, (Washington, DC: The Millennium Project, 2009), compact disc.

70 Gordon and Glenn, "Environmental Scanning."

71 Olaf Helmer, *Analysis of the Future: The Delphi Method* (Santa Monica, CA: RAND, 1967), pp. 7-9.

the majority opinion and therefore builds consensus. The coordinating cell may also discard outlying opinions at each stage, further building consensus. Successive questionnaires may be sent until the coordinators are satisfied that a consensus has formed.<sup>72</sup>

The major drawback of the Delphi Method is that it artificially forces the respondents and the coordinating body to produce a consensus, as that incentive itself may bias the results. This is especially problematic when the future is highly uncertain and a consensus answer is likely naïve and dangerous if acted upon. Because of the stress on consensus, individuals may also be hesitant to state unique views that fall outside of mainstream expert opinion, similar to the reputational pressures found in traditional group settings. Separately, the views and actions of the participating experts and the coordinating cell are still subject to individual and group bias and the basic process itself is not based on a particular formalized or scientific forecasting method.<sup>73</sup> The Delphi Method may be good at forecasting technological developments over a five-to ten-year period, during which existing trends are likely to continue forward, but this method struggles to provide clarity beyond that timeframe due to the unpredictability of technological innovation. On social developments, the method is much less useful, as chance has an even greater near-term role in these events.<sup>74</sup>

In review, several forecasting methods are available to researchers, yet the credibility and accuracy of each method varies based on context, including the complexity of the focal issue, the availability of relevant data, and the relevant time horizon. Moreover, although the predictive methods above are certainly relevant in specific contexts, they are of limited use to policymakers in the development of long-term policy and strategy, which must anticipate and address a broad range of potential futures.

## The Track Record of Forecasting China's Future

Despite the variety of predictive methods, consistent ways of accurately forecasting China's future remain elusive. Most formal methods struggle to yield correct predictions in the social sciences, as noted above, and the field of China Studies is no exception. Informal expert judgment is thus the principal, yet still flawed, method on which most forecasts have relied. Unfortunately for policymakers in the post-Mao era, experts have made countless widely differing predictions of China's future, with scenarios ranging from China's impending collapse to its certain global domination.

The best summary and analysis on forecasts of China's future is contained in Roger Irvine's *Forecasting China's Future: Dominance or Collapse*, a unique and comprehensive study that places these forecasts in methodological and historical perspective, evaluating the relative merits and success of differing methodologies. Surveying the literature from the 1970s

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<sup>72</sup> Rescher, 92-93.

<sup>73</sup> Rescher, 96-97.

<sup>74</sup> Rescher, 94-96.

onward, Irvine finds that Western experts attempting to predict China's future generally fall within three camps:

1. An optimistic group predicting China's political and economic ascendance;
2. A pessimistic group predicting China's political and economic stagnation, setback, or even collapse; and
3. A cautious group presenting more nuanced forecasts that acknowledge considerable uncertainty and include a range of possible future scenarios.<sup>75</sup>

While expert opinion of all three types has been present since the late 1970s, the relative strength of each viewpoint has varied over distinct historical periods. Deng Xiaoping's launching of reform and opening up policies in 1978, which encouraged political and economic liberalization, resulted in most China experts making hopeful and optimistic predictions of China's continued economic growth and political reform. This optimistic outlook promptly died in the aftermath of the 1989 Tiananmen Square massacre, after which many experts questioned the survivability of the Chinese Communist Party (CCP) in the face of both Chinese domestic unrest and international momentum for liberal political reform, marked by the collapse of the Soviet Union and subsequent opening of the former Soviet republics.<sup>76</sup>

Yet, from approximately the mid-1990s onward, all three viewpoints have been strongly advocated for by different groups of China experts. With China's robust economic growth throughout the 1990s, its accession to the World Trade Organization in 2001, and its perseverance through the global financial crisis of 2007-2009, an optimistic group of China watchers, including Daniel Burstein, Arne de Keijzer, Albert Keidel, Oded Shenkar, Martin Jacques, and Arvind Subramanian, along with investment bank analysts at Morgan Stanley and Goldman Sachs, grew confident about the capacity of the CCP to endure and for China

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75 Roger Irvine, *Forecasting China's Future: Dominance or Collapse?* (Abingdon, Oxfordshire: Routledge, 2016), pp. 22-75. Experts in general qualify or couch their forecasts as a matter of course, leaving considerable room for maneuver in the face of future unexpected events. Many experts therefore do not fall cleanly into these three groups, particularly the first two. The degree to which experts acknowledged uncertainty or emphasized the likelihood of one particular scenario determined their placement. The expert groupings below, including many of the experts and sources, largely reflect those created by Irvine, with some modifications by this chapter's author based on recent expert publications and statements. For additional insight on how experts usually qualify their predictions, see: Tetlock, xxxiii.

76 Irvine, 22-27.

to continue its rapid economic growth well into the 21<sup>st</sup> Century.<sup>77</sup> Within this group, some experts are hopeful about China's integration into the existing liberal international order, while others see China eventually surpassing the United States as the world's dominant power, altering the prevailing liberal order.

Simultaneously, a pessimistic expert group—including Gerald Segal, Gordon Chang, Minxin Pei, John Lee, David Shambaugh, and Jonathan Fenby, among others—has claimed that China faces a coming period of stagnation, decline, or even collapse, due to a range of political, economic, and social factors.<sup>78</sup> Those in this camp usually argue that the CCP will struggle to maintain its monopoly on political power if it does not conduct political reforms. Continued economic growth and the management of rising demands from Chinese citizens necessitate political openness and accountability, and the CCP's refusal to reform will therefore hamper China's development. This group has been the smallest of the three over the last twenty-five years.

In the middle of these two groups is a third cluster of experts who see China as a land of contradictions and, in their forecasts, emphasize uncertainty and the possibility of a range of futures. China scholars such as Orville Schell, Kenneth Lieberthal, Andrew Nathan, Michael Swaine, and Lonnie Henley have avoided single-scenario forecasts because of the complexity and unpredictability of events in China.<sup>79</sup> Scenario forecasting workshops and similar exercises conducted by several organizations, including the Nautilus Institute for Security and

77 Irvine, 37-44. Sources that Irvine cites include Daniel Burstein and Arne de Keijzer, *Big Dragon: the Future of China* (New York, NY: Touchstone, 1998); Albert Keidel, *China's Economic Rise—Fact and Fiction*, (Washington, DC: Carnegie Endowment for International Peace, 2008); Oded Sehnkar, *The Chinese Century: the Rising Chinese Economy and its Impact on the Global Economy, the Balance of Power, and Your Job* (Upper Saddle River, NJ: Wharton School Publishing, 2006); Martin Jacques, *When China Rules the World* (New York: NY: Penguin Group, 2009); Chetan Ahya and Andy Xie, "India and China: A Special Economic Analysis," Morgan Stanley, July 26, 2004; and Dominic Wilson and Roopa Purushothaman, *Dreaming with BRICs: The Path to 2050*, Goldman Sachs, October 1, 2003. For another relevant source, see Arvind Subramanian, "Why China's Dominance Is a Sure Thing," *Foreign Affairs* 90, no. 5, September/October 2011, pp. 66-78.

78 Irvine, 24-37. Sources that Irvine cites include David S. Goodman and Gerald Segal, eds. *China Deconstructs: Politics, Trade, and Regionalism* (New York, NY: Routledge, 1994). David S. Goodman and Gerald Segal, *China Without Deng* (Sydney, New South Wales: Imprint, 1995); Gordon Chang, *The Coming Collapse of China* (New York: Random House, 2001); Minxin Pei, *China's Trapped Transition* (Cambridge, MA: Harvard University Press, 2006); John Lee, *Will China Fail?* (St. Leonards, New South Wales: The Centre for Independent Studies, 2007). Other relevant sources include Jonathan Fenby, *Will China Dominate the 21<sup>st</sup> Century?* (Cambridge, UK: Polity Press, 2017). David Shambaugh, "The Coming Chinese Crackup," *The Wall Street Journal*, March 6, 2015. Shambaugh is now decidedly pessimistic about the endurance of China's existing political system, though he still acknowledges a range of futures in his writings (see David Shambaugh, *China's Future* (Cambridge, UK: Polity Press, 2016), pp. 1-6.

79 Irvine, 51-54. Sources that Irvine cites include Orville Schell, "China: Boom or Boomerang," *Truthdig*, December 3, 2005; Kenneth Lieberthal, "China in 2033: What Will China Look Like in 30 Years?" *China Business Review* 30, no. 2, March/April 2003, pp. 42-48. Michael Swaine, *China: Domestic Change and Foreign Policy* (Santa Monica, CA: RAND, 1995). Other relevant sources include Andrew Nathan, "Andy Nathan on China's Future," Interview by Gideon Rose, *Foreign Affairs*, July 9, 2015, available at <https://www.foreignaffairs.com/videos/2015-07-09/andy-nathan-chinas-future>; Michael Swaine et al., *China's Military and the U.S.-Japan Alliance in 2030: A Strategic Net Assessment* (Washington, DC: Carnegie Foundation, 2013). Lonnie Henley, "Whither China? Alternative Military Futures, 2020-30," in Roy Kamphausen and David Lai, eds., *The Chinese People's Liberation Army in 2025* (Carlisle, PA: U.S. Army War College Press, 2015).

Sustainable Development, the National Bureau of Asian Research, the Center for Global Affairs, and the Strategic Studies Institute, also underscore the belief of many experts that China's future over the medium to long term is highly uncertain and a range of prospective futures merits study.<sup>80</sup>

Over this period of nearly 40 years, most formal forecasting methods have struggled to predict China's future due to a lack of relevant data, an inability to incorporate complexity, and the general forecasting challenges of uncertainty, chance, chaos, and human choice. A notable example of the difficulty of applying formal methods to social science forecasts on China is Henry Rowen's 1996 prediction that China would democratize by 2015. According to Rowen, China's per capita GDP would reach a level in 2015 such that, based on modernization theory and relevant historical data on the correlation between wealth and democratization, social forces in China would compel a democratic transition.<sup>81</sup> An estimate based on empirical data on democratic transitions and trends in China's economic growth may seem convincing on the surface, but it underlies the difficulty of using formal predictive methodologies in the social sciences. As with most inductive social sciences theories, modernization theory, derived from empirical data on economic output and democratic transitions, is not a strict law for specific cases like one finds in the physical sciences but rather an instructive generalization useful only in broad sweeps.

Due to the inapplicability of formal methods in most contexts, forecasts of China's future have primarily been based on informal methods, especially individual expert estimates. Yet even expert judgement has revealed great shortcomings. Equally respected China analysts offer conflicting, mutually exclusive forecasts. Trends in expert forecasts on China also indicate that many expert predictions can be backward looking, overly influenced by recent past events, rather than forward looking. Moreover, the influence of formational experiences, which are at the root of one's bias, appears to be driving an emerging generational divide among Western China analysts.<sup>82</sup>

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80 Irvine, 66-68. Among several examples, Irvine cites *China 2020* (New York: New York University Center for Global Affairs, 2009). Other relevant sources include "What Road Ahead? Scenarios for the Future of United States—China Relations 2001-2010," Nautilus Institute for Security and Sustainable Development, 2001; Mercy Kuo and Andrew D. Marble, "China in 2020: Bridging the Academic-Policy Gap with Scenario Planning," *Asia Policy*, No. 4, July 2007, pp. 2-6. Roy Kamphausen and David Lai, eds., *The Chinese People's Liberation Army in 2025* (Carlisle, PA: U.S. Army War College Press), 2015.

81 Henry S. Rowen, "The Short March: China's Road to Democracy," *The National Interest*, September 1, 1996, available at <http://nationalinterest.org/article/the-short-march-chinas-road-to-democracy-416>.

82 Age is by no means the only factor that shapes the views of China analysts and, as noted, exceptions to this generalization are numerous. Nevertheless, these generational differences in part explain recent emerging divisions among China analysts, particularly as this expert community has shifted to a more competitive approach to China starting in the mid-2010s. For examples of this generational divide, see M. Taylor Fravel, J. Stapleton Roy, Michael D. Swaine, Susan A. Thornton and, Ezra Vogel, "China is not an enemy," *The Washington Post*, July 3, 2019 and Kurt M. Campbell and Ely Ratner, "The China Reckoning: How Beijing Defied American Expectations," *Foreign Affairs* 97, no. 2, March/April 2018. I am indebted to Toshi Yoshihara for this insight.



## How Useful is Prediction in National Security Planning?

In sum, predictive methodologies can produce reasonably accurate results in some fields for six to twelve month time horizons. In a few fields, such as the demographic outlook, predictions 20–30 years forward can be relatively accurate. It is, however, really only in very few areas, such as astrological movements of planets and stars, geographic landforms, and tidal flows, where highly accurate predictions can be made decades ahead.

There are, in consequence, three major lessons concerning the use of forecasting as a development tool in defense and broader national security planning:

1. No matter which methodology is used, forecasting in most relevant fields is difficult with resulting judgements highly uncertain, except for the very near term.
2. Expert group judgement can be more credible and instructive than individual expert judgment when the group is composed of diverse, open-minded, and pragmatic individuals and when ‘information signals’ and ‘reputational pressures’ are properly addressed.
3. For a complex country such as China, single scenario predictions are prone to error and credible forecasting efforts must instead identify a range of potential futures.



## APPENDIX B

# The Practicalities of Scenario Development

**Ross Babbage**

At the core of the planning approach described in this report is the desirability of crafting well-researched representative scenarios for the situation 15 years into the future. Peter Schwartz in his celebrated book, *The Art of the Long View*, describes this process in eight essential steps.<sup>83</sup> A slightly tailored version is, as follows:

### **Step One: Identify the Focal Issue or Decision**

The starting point is not to analyze possible futures but rather to identify, and describe accurately, the most critical decision that American and allied defense and security planners will need to take during the coming 15 years. This report argues that the single most important decision, or set of decisions, can be expressed as:

The strategies, operational concepts and capabilities that will best equip the close allies to deter and, if necessary, defeat China in the period to 2035.

### **Step Two: Identify the Primary Strategic Variables in the Theater**

With the key decision (or goal) clearly stated, there is a need to identify the primary factors that will determine whether the close allies succeed or fail in this task. What are the forces that will influence whether the close allies are able to optimize their preparations for deterring or defeating China? What are the most important features of China and the relevant

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<sup>83</sup> Peter Schwartz, *The Art of the Long View: Paths to Strategic Insight for Yourself and Your Company*, (Crown Business, New York, 1996).

agencies of the Chinese regime? What are the key facts about the allies and other actors in the theater? Primary influences are likely to include political-ideological, economic, social, technological and military factors, at a minimum. These key factors and variables need to be identified and listed.

### **Step Three: Identifying and Analyzing the Driving Forces**

In this step the factors listed in Step Two need to be researched in some depth to select those forces that are likely to be the primary drivers of China's future. These driving forces will probably include some combination of political, demographic, economic, technological, and some other forces. In this step it is important to consider the possibility of some new or divergent forces arising to push the Chinese regime in an unexpected direction.

### **Step Four: Rank the Driving Forces According to their Level of Importance and Uncertainty**

In this step the driving forces identified in Step Three are rated or scored according to their importance (or relevance) to the primary decision, and then their level of uncertainty. There will be some factors that are largely pre-determined, such as nearly all geographic and demographic variables. These factors can be foundational and largely shared across most, if not all, of the scenarios. Some critical uncertainties will also be identified. These will likely become major distinguishing features between the alternative scenarios as they are constructed.

The primary purpose of Step Four is to identify the 3–4 driving forces that are most important *and* most uncertain.

### **Step Five: Selecting Scenario Logics**

The purpose of this step is to start to develop the skeletons of a modest number of scenarios. While the predetermined elements may be foundations in all scenarios, the primary uncertain factors can each be considered along a high-low axis so as to paint pictures of quite different types of future. For example, if economic growth and technological advancement are both identified as uncertain driving forces, it may be sensible to consider a scenario in which both economic growth and technological advancement are high and a second scenario where one or both are low. While a very large number of scenarios is possible, the intent is to end up with just a few—preferably three or four—that, as a set, provide a reasonable representation of all of the scenario space in 2035.

The distinguishing features of the selected scenarios would ideally be such that each of them would drive allied decision-makers to select different strategies, operational concepts and sets of capabilities.

## Step Six: Fleshing Out the Scenarios

In this step there is a need to stand back and consider the most sensible combinations of uncertain forces in order to craft credible story lines for each scenario. For instance, if one scenario envisages the Chinese economy stalling and a succession of technological programs suffering serious reverses, it would be sensible to couple those drivers with increased constraint in defense spending and possibly some dissent in the party elite. Alternatively, if a scenario sees the Chinese economy thriving and new technological breakthroughs being achieved ahead of the West, the outlook for the military and for the party leadership would probably be more positive. Whatever the combinations chosen, short narratives concerning the development of each scenario need to be written that include descriptions of credible pathways that China would travel to reach each future in 2035.

Each chosen scenario should also be given a short, pithy name. Labels might include: Xi Wins, The Party's Dead-End, or possibly Rebellion in the Ranks.

## Step Seven: Considering the Implications of Each Scenario

With a set of draft scenarios now in place it is time for the planners to rehearse the future. There is a need to consider the key decisions allied security planners would need to take in the circumstances of each scenario. Hence, if Scenario A is the shape of China in 2035, what strategies, operational concepts and capabilities should be given priority now? What Chinese vulnerabilities can be seen in this scenario and what opportunities are there for the close allies? Developing a strong and coherent approach is likely to warrant high-level discussions, workshops, and probably some gaming. The preferred decision (or package of decisions for Scenario A) needs to be recorded, together with notes on the rationale. Then, the same questions would need to be addressed to select the best mix of strategies, operational concepts and capabilities for scenarios B, C, and D.

At the end of this process it is important to list the decisions (or capability components) that are common to all or most of the scenarios. These are likely to become core development priorities for defense and security development, especially in the first years of the planning period.

## Step Eight: Identifying and Plotting the Lead Indicators

With the scenarios now set, it is time to return to the story lines developed in Step Six and spell out a credible sequence of events that could, or probably would, take place were China to be heading towards each scenario. As discussed in Chapter 1, and illustrated in Figure 2, the sequence of likely events then needs to be plotted as a succession of lead indicators heading towards each alternative future.

Once this succession of signposts for each scenario is set, intelligence agencies can be tasked with monitoring developments and switching on orange and red warning indicators as

time passes. This should provide clear indications of whether China's trajectory is towards scenario A or B or possibly some combination of scenarios. Once a pattern of events starts to become apparent, decisions can be taken promptly to proceed to put in place the strategies, operational concepts and capabilities that have already been identified in Step Seven as being most appropriate.

## **Review and Reset Mechanisms**

While the paragraphs above describe a process of developing indicative alternative scenarios to guide defense and security planning over a 15-year period, it is not proposed that this planning be undertaken once and then left to run its course for a decade and a half. It is rather suggested that the process should be used to set the direction of strategy, operational concept and capability development for an initial 3–5 year period and then repeated. This would allow new scenarios to be crafted to take account of changes in the scenario space. It would also permit new strategy, concept and capability options to be assessed for their potential application. While the second and subsequent rounds could, and perhaps should, commence with a clean sheet of paper, they would also provide an effective review, update and reset mechanism to ensure that planning and preparations remain on an optimal course.

The timing for second and subsequent rounds of scenario planning are likely to be driven by a number of factors. In some countries the national electoral cycle would probably be a major factor determining the rollover of the planning cycle. There could be substantial benefits in an incoming government being involved in, and effectively owning, the relevant phases of such a process soon after gaining power.

## APPENDIX C

# Primary Scenarios for China's Political Leadership and Political System in 2035

Aaron Friedberg and Nadège Rolland

## Introduction

In describing and categorizing the various possibilities for China's domestic political system over the next 10-15 years it is useful to begin with Samuel Huntington's observation that "the most important distinction among countries concerns not their form of government but their degree of government."<sup>84</sup> According to Huntington, both dictatorships and democracies can have what he describes as "effective" political systems. In countries where "effectiveness" or "the degree of government" is high there exists "an overwhelming consensus among the people on the legitimacy of the political system" and political institutions are "adaptable [and] coherent" with "effective bureaucracies . . . working systems of civilian control over the military, extensive activity by the government in the economy, and reasonably effective procedures for regulating succession and controlling political conflict."<sup>85</sup>

For our purposes, the key question regarding the *form* of government in China is whether or not the CCP retains its monopoly on political power. While it will be easier to determine whether such a monopoly still exists than to decide if the resulting political system is or is not effective, for purposes of discussion we can distinguish among four notional scenarios, each of which will be described more fully below:

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84 Samuel P. Huntington, *Political Order in Changing Societies* (New Haven: Yale University Press, 1968), p. 1.

85 Huntington, p. 1.

**TABLE 2: CHARACTERISTICS OF ALTERNATIVE CHINA SCENARIOS**

	CCP retains monopoly	CCP loses monopoly
High effectiveness	Xi's Jinping's Dream	Liberalization
Low effectiveness	Stasis	Militarism

Each of these possibilities can be thought of as arising from the interplay between two sets of forces. On the one hand, as many Western observers have been arguing for some time (and as at least some of their Chinese counterparts clearly agree) there are powerful processes at work that ought to be driving China towards some type of political change. These processes have been categorized and explained in different ways, and with varying degrees of emphasis, but virtually all analysts begin with the assumption that economic growth is the primary engine of social development, and potentially of political evolution as well. In Europe in the 19th century, and in Asia too, especially in the second half of the 20th century, growth caused societies to become increasingly diverse and complex. Above all, economic development led to the emergence and expansion of a middle class which then acted as the standard bearer for political reform. In one country after another, these newly empowered members of society pressed for political rights and personal freedoms commensurate with their economic liberties and reflective of their growing resources. It is largely for this reason that since the early 1990s so many scholars and pundits have believed that the PRC was, in the words of the late RAND economist Henry Rowen, on a “short march” to democracy.<sup>86</sup> It is for this reason too that so many political leaders supported the policy of vigorous economic engagement with China.

The fact that economic growth has not yet resulted in political liberalization could be an indication that China is somehow unique and that the same mechanisms that have linked these two processes in other societies are for some reason absent there. Alternatively, it is possible either that the drivers of liberalization have simply not gained sufficient strength and/or that there are opposing forces at work that have thus far tended to counteract and constrain their effects. In the Chinese case, of course, the most obvious and likely the most important constraint on liberalization has been the determined opposition of the Communist Party.

If not for the ruthlessness, resolve and increasing resources of the CCP, China might already have followed the path of other countries with authoritarian regimes and made the transition to democracy. For the past three decades, however, the factors constraining political change have remained stronger than those driving it. Looking to the future the question is whether, and if so how, the balance between these two sets of opposing forces might change.

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<sup>86</sup> Henry S. Rowen, “The Short March: China’s Road to Democracy,” *The National Interest*, September 1, 1996, available at <http://nationalinterest.org/article/the-short-march-chinas-road-to-democracy-416>.



Four possibilities present themselves. In the first two (*Xi Jinping's Dream* and *Stasis*), the forces of constraint continue to hold the drivers of change in check, albeit to varying degrees and with very different implications for the effectiveness of what remains a CCP-dominated state. In the second two scenarios (*Militarism* and *Liberalization*), the drivers of change overwhelm the constraints, at least to the extent of ending the CCP's monopoly on political power, but the systems of government that emerge from this transformation are different in both their institutional form and their presumed effectiveness.

### Political Scenario 1: Xi Jinping's Dream

As recently as 2012, on the eve of Xi Jinping's accession to power, many experienced and well-informed observers were convinced that the resilience of the CCP regime, its ability to continue to constrain the political effects of rapid socio-economic development was, in the words of Andrew Nathan, "approaching its limits" and that some kind of dramatic change was in the offing.<sup>87</sup> Pointing to recent protests by citizens groups and human rights activists, two Chinese scholars concluded at the time that a "rising independent civil society" posed an increasing challenge to the regime and gave evidence that "a fundamental political transformation" was already well underway.<sup>88</sup> According to Larry Diamond, a leading expert on democratic transitions, despite mounting popular frustration over "corruption, collusion, criminality, and constraints on free expression," among other problems, the CCP leadership remained "frozen and feckless on the grand question of long-term political reform." As a result, Diamond concluded, "China faces a looming crisis of authoritarianism that will generate a new opportunity for democratic transition in the next two decades and possibly much sooner."<sup>89</sup>

Diamond's longer term prediction may yet be borne out (as will be discussed in Scenario 4, below). For the moment, however, events appear to be moving in the opposite direction to the one that so many anticipated only a few years ago. Everything Xi Jinping has done since taking office suggests both that he is acutely aware of the many challenges facing his regime and that he is determined to meet them, preserving CCP rule by any means necessary. In terms of the two sets of contending forces described above, Xi recognizes the growing strength of the drivers and is doing everything he can to neutralize their effects by bolstering the constraints on change. At the same time as he strengthens his own personal grip on power Xi has taken steps to enhance the power of the Party in relation to every other element in Chinese society, including the state, the military, business, and the educational system.

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87 Andrew J. Nathan, "China at the Tipping Point? Foreseeing the Unforeseeable," *Journal of Democracy* 24, no. 1, January 2013, p. 20.

88 Yu Liu and Dingding Chen, "Why China Will Democratize," *Washington Quarterly* 35, no. 1, Winter 2012, p. 41.

89 Larry Diamond, "The Coming Wave," *Journal of Democracy* 23, no. 1, January 2012, pp. 6, 11-12.

In addition to cracking down on the Party through an aggressive anti-corruption campaign, Xi has also gone even further than his predecessors in suppressing dissent, shutting down NGOs, persecuting human rights advocates, intensifying repression of alleged Uighur and Tibetan “separatists,” imposing ever tighter controls on the internet and social media, and launching a new, nationwide social credit ecosystem that will use big data analytics to assess the activities of virtually every man, woman, and child in China.

But Xi does not seek to rule by repression alone. At his direction the Party has launched fresh ideological indoctrination campaigns aimed both at its members and at ordinary citizens. Picking up where his more cautious predecessors left off, Xi has also adopted a more ambitious and, in certain respects, more aggressive foreign policy stance that is intended, at least in part, to stir nationalist sentiments and mobilize popular support for the regime.

Last but not least, Xi clearly acknowledges the need for some kind of dramatic measures to sustain economic growth. At least in the near term he appears to be doing this by resorting to the familiar expedient of investing even more in infrastructure development, both within China’s borders and now also abroad, as part of his signature Belt and Road Initiative. In the somewhat longer term Xi is counting on massive state-directed industrial policy programs, like the Made in China 2025 initiative, to propel “national champions” to dominant positions in global markets across a wide range of high-tech sectors. Among their other purposes, these efforts are intended to yield major increases in productivity through the mastery of next-generation production techniques, propelling future growth even as China’s population ages and it loses its demographic edge.

If Xi’s plans succeed, in 10–15 years, a reformed and revitalized Communist Party will sit atop a newly energized economy and a society that, if not entirely complacent, is even more securely under CCP surveillance and control. The drivers of change will still be present and, thanks to continued, healthy economic growth, they may even be getting stronger in some respects. But ongoing improvements in living standards will also enable the regime to continue to buy the support, or at least the acquiescence, of a significant portion of an expanding middle class. Visible victories in foreign policy, including the final resolution of the Taiwan issue, will stir national pride and boost the stature of the CCP in the eyes of the Chinese people. When compared to the deepening difficulties of the democracies (made worse by their loss of technological advantage), the success of the “China model” in generating prosperity and preserving political stability will raise its stature internationally while demoralizing potential critics, both at home and abroad. Remaining doubters will find that their every word and deed is monitored by the state, while predictive models built from innumerable bits of information collected about the lives of hundreds of millions of people enable the security services to identify possible troublemakers before they have a chance to act or, in some cases, even to entertain a deviant thought.

Externally, a more powerful and secure regime may feel less need to provoke crises and confrontations solely for purposes of domestic mobilization and it will be able to rely primarily on the prospect of economic punishment, rather than crude threats of force to

exert its will over other governments. Having achieved many of its long-standing objectives, the scope and scale of Beijing's ambitions will grow, but it will be more relaxed and confident about achieving them.

A potential flaw in this picture has to do with one of the features that Huntington identifies as critical to maintaining regime effectiveness: reliable means for regulating elite conflict and managing leadership succession. By discarding term limits and persecuting actual and potential rivals, including close associates of his predecessors, Xi Jinping has clearly damaged, if not destroyed, the mechanisms put in place for these purposes by Deng Xiaoping. Xi has possibly made it more difficult for himself to retire, increasing the risk of an assassination or coup attempt, and he has raised the stakes in whatever process is eventually used to choose his successor. The struggle to become the next CCP leader could be, quite literally, a duel to the death.

## Political Scenario 2: Stasis

Xi Jinping dreams of a technologically empowered totalitarianism, a more capable successor to the less efficient systems of the twentieth century in which advances in science and engineering enable innovation and sustained growth coupled with complete societal control. The successful fulfillment of Xi's vision would represent a final victory for the forces of constraint over the supposedly unstoppable drivers of change, an illiberal version of the end of history.

But, of course, Xi's plans may fail, in whole or in part. Despite all the resources being poured into them, his ambitious programs for achieving technological breakthroughs, boosting productivity and sustaining growth may not yield the desired results. The Belt and Road Initiative could also end up being a massive waste of money, with the costs of incomplete and inefficient projects far exceeding whatever economic or geopolitical benefits they might produce. Weighed down by the burdens of debt, a poisoned environment and an aging population, having lost its advantages as a low-wage manufacturing platform and facing an array of advanced industrial countries no longer willing to accept its predatory trade practices, China could find itself sliding into the dreaded middle income trap.<sup>90</sup>

Slower growth would probably yield deepening disillusionment and rising discontent, but it might also produce a middle class whose ranks are expanding less rapidly and whose members are more concerned with preserving their hard-won gains than with squandering their energies in agitating for political rights. Especially after several decades of rising expectations and bold promises, stagnation would likely fuel cynicism and resentment,

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90 After a period of rapid expansion driven by urbanization and the initial stages of industrialization, many developing countries have had difficulty in sustaining growth rates sufficient to enable continued improvements in per capita income levels. China is now a middle income country, but some analysts believe that it will have difficulty moving into the ranks of the wealthiest and most advanced nations. For a discussion of the many obstacles that must be overcome to avoid this fate see World Bank and the Development Research Center of the State Council, People's Republic of China, *China 2030: Building a Modern, Harmonious, and Creative Society* (Washington, DC: World Bank, 2013).

sentiments made more intense by the irritation that comes from constant exposure to an inescapable barrage of propaganda.

Hard times will provide an additional incentive for low and middle-level bureaucrats and Party officials to resort to corruption. Notwithstanding tighter rules and restrictions, those with sufficient means and the right connections will take steps to move money and family members to safe havens outside of China. Despite periodic waves of arrests and occasional show trials, the energy will drain out of Xi's anti-corruption campaign and familiar patterns of rent-seeking behavior, never entirely banished, will begin to reassert themselves. As the center's capacity for striking fear and commanding obedience ebbs, so too will its ability to implement reforms or to launch new policy initiatives.

After a period of seeming remission at the start of the Xi era, what David Shambaugh has described as "the terminal cancer plaguing the Chinese communist body politic" will gain renewed strength.<sup>91</sup> After a few years of failure and frustration Xi will find himself forced to cede some of his decision making power and the CCP will move back towards something more closely resembling a collective leadership. Having negotiated promises of protection for himself and his family, Xi will be eased into retirement. Alternatively, like Nikita Khrushchev in 1964, he may be unceremoniously removed from office amidst allegations that he is a "hare-brained schemer" whose misbegotten plans have endangered the stability of the state and the survival of the Party.

As was true in the Soviet Union after Stalin's death, and in China after the demise of Chairman Mao, Xi's departure may be followed by the acceptance of new, tacit rules meant to keep elite conflict within bounds and prevent the emergence of any new "maximum leader." The CCP will continue its rule, using ever-increasing doses of coercion and repression to keep order and adopting an even more truculent and antagonistic posture towards the outside world to deflect blame for a deteriorating quality of life and to justify its continued grip on power.

### Political Scenario 3: Militarism

Shambaugh argues that "repression—like chemotherapy for someone who has cancer—can work for a while, but not forever."<sup>92</sup> Proceeding from the assumption that this medical metaphor applies, the next two scenarios consider what may happen as additional doses of coercion begin to lose their efficacy and the drivers of change begin to overwhelm the forces of constraint.

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91 David Shambaugh, *China's Future* (Cambridge: Polity Press, 2016), p. 129.

92 Shambaugh, *China's Future*, p. 134.

As Minxin Pei notes, authoritarian regimes generally collapse in two stages: “a long period of decay followed by a quick breakdown.”<sup>93</sup> With the passage of time, even as the outward form of government remains unchanged, declining performance, ideological atrophy, expanding corruption and rising elite tensions combine to eat away at governmental effectiveness. At some point, the fragility of existing institutions is revealed by a triggering event that causes the entire structure to come crashing to the ground. Such events unleash cascading effects as growing portions of the population lose their fear of repression (or become willing to die for the cause of change) and latent splits within the elites, sometimes over who is to blame for a recent setback, or regarding the question of how harshly to deal with public protests, burst fully into view. The resulting breakdown in cohesion can lead in many different directions, including to coups, civil wars and mass revolts.<sup>94</sup>

Andrew Nathan lists an array of possible triggers that could bring fundamental change to China, including “the bursting of the bubble economy, violent confrontations with local demonstrators, a protracted power struggle within the regime, or a natural disaster or public-health crisis that exposes scandalous incompetence or corruption.”<sup>95</sup> Given the importance that the CCP has attached to restoring national dignity and regaining “lost” territory, Nathan concludes that “the power-deflationary event to which this particular regime is most vulnerable is a foreign humiliation.”<sup>96</sup> A visible international setback could trigger public anger, nationalist demonstrations, harsh recriminations and mutual finger-pointing between military and civilian leaders and within the Party-state elite.

Consider one such scenario: in the aftermath of a military defeat at the hands of Japan in the East China Sea, violent mass demonstrations break out in cities across China. Hyper-nationalist, anti-Japanese sentiments quickly become mingled with expressions of anger directed at the CCP regime. After several days of unsuccessful attempts to quell unrest, the leadership orders PLA units into action to dispel protesters and restore order. Sympathetic with the patriotic sentiments being expressed in the streets, stung by the civilian leaderships’ efforts to blame them for the recent fiasco, and fearful that they may be about to be purged, a group of military leaders decides to stage a coup. The members of the Politburo are arrested and, after a few days of sporadic fighting, PLA units loyal to the coup leaders suppress poorly coordinated opposition. A new “patriotic national unity government” is declared, with a group of generals in command. Top Party leaders, accused of incompetence, treason, and corruption, are put on trial and hastily executed.

Even if they are able to decapitate the CCP regime and seize power in Beijing, the nation’s new rulers would face enormous challenges in unifying and actually governing the country.

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93 Minxin Pei, “Transition in China? More Likely Than You Think,” *Journal of Democracy* 27, no. 4, October 2016, p. 8.

94 For an assessment of patterns and trends since the 1950s, see Andrea Kendall-Taylor and Erica Frantz, “How Autocracies Fail,” *Washington Quarterly* 37, no. 1, Spring 2014, pp. 35-47.

95 Nathan, “Foreseeing the Unforeseeable,” p. 23

96 Ibid.

Among these, the most pressing would be the necessity of “de-CCPifying” the administrative apparatus at all levels, creating new government institutions to channel the interests and secure the loyalty of powerful groups in society, and promulgating an ideological substitute for Marxism-Leninism-Maoism-Xi Jinping Thought.

The result of these transformations would likely be a government that is even more nationalistic, militaristic, and authoritarian than its CCP predecessor, but also less competent in conducting foreign relations and less effective in its attempts to manage the nation’s economy and govern its people. Such a regime might be especially prone to risky, aggressive behavior. As Diamond notes, “a sudden collapse of the communist system could give rise, at least for a while, to a much more dangerous form of authoritarian rule, perhaps led by a nationalistic military looking for trouble abroad in order to unify the nation at home.”<sup>97</sup>

### Political Scenario 4: Liberalization

Diamond speculates that, because it would be “incapable of governing a rapidly modernizing, deeply networked, middle-class country facing complex economic and social changes,” a post-CCP, PLA-dominated government might give way eventually to a more representative, liberal and effective regime.<sup>98</sup> But this is not the only conceivable pathway from authoritarianism to democracy. Perhaps China will be able to skip this repressive intervening phase, proceeding directly from 70 years of CCP rule to some form of democratic government.

While it cannot be ruled out entirely, the likelihood of a true popular revolution sweeping the current regime from power appears quite low. At least for the moment, the ruling elites seem highly motivated and utterly determined to retain power. Since Tiananmen, the regime has also put in place a multi-layered system of surveillance and repression designed to repress popular unrest before it can begin to gather momentum.

The presence of high-ranking reformers has enabled other regimes to move directly from dictatorship to democracy. Although such people could emerge, there is nothing to suggest the existence of a reform faction in the current leadership that might be sympathetic to demands for radical change. Still, at some point, accumulating evidence of stagnation and declining effectiveness could spur some rising potential future leaders to undertake a quiet search for dramatic solutions. This is what happened in the Soviet Union in the mid-1980s and, as recently as the early years of this century, some observers hoped that a similar process was underway behind the scenes in China. Writing in 2004, political scientist Bruce Gilley imagined a sequence of events in which, instead of violent regime collapse, a severe

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97 Diamond, “The Coming Wave,” p. 12.

98 Ibid.

crisis might result in the CCP being peacefully “extricated’ from office by reformers in its own ranks.”<sup>99</sup>

If there are any officials remaining in the CCP hierarchy with anything even remotely resembling liberal sympathies, they are lying very low at present. But the obstacles to top-down reform may extend beyond the inner circles of the Party-state apparatus. Having atomized society and denied the existence of any form of legitimate, organized opposition, the CCP has left itself no one with whom to negotiate a peaceful transformation. For this reason, Pei argues that China’s most likely path to democracy is what he labels “refolution,” a process in which what begins as “limited reform initiated by the old regime . . . ends with its involuntary exit from power.”<sup>100</sup> In some cases, those in power permit opposition parties to form and organize elections that they unexpectedly lose. In others, as happened in the Soviet Union under Gorbachev, when the regime loosens its grip it unleashes a torrent of criticism and pent-up societal resentment that erase what remains of its legitimacy, undermine its popular support, and demoralize its defenders to the point where they become either unwilling or unable to prevent its removal from power.

The manner in which a transition takes place will likely have a significant impact on the kinds of policies that a newly democratic China pursues. Upheavals that are prolonged and violent will leave the country damaged and weakened in many respects, but could also lead to the emergence of a new government that is especially prone to use extreme versions of nationalism to rally support and may therefore be more inclined to engage in external aggression. Even if the process of change is less disruptive, history suggests that regimes in transition from stable authoritarianism to stable democracy are especially prone to disruptive international behavior. Once again, the culprit appears to be belligerent nationalism, whipped up as new and old elites compete with one another for support from a newly empowered public.<sup>101</sup>

Notwithstanding the risks associated with such a bumpy transition, in the somewhat longer run the prospects for peace and stability should improve as China settles into its new identity as a democratic republic. As the values and institutions of liberal democracy take hold there will be open debate and real competition over national goals and priorities. Aspiring leaders preoccupied with prestige and score-settling will have to compete with others who stress the virtues of international cooperation and the promotion of social welfare. The demands of the military-industrial complex will be counterbalanced to a degree by groups who favor more spending on health care, education, and the alleviation of environmental

99 Bruce Gilley, *China’s Democratic Future: How It Will Happen and Where It Will Lead* (New York: Columbia University Press, 2004), p. 118.

100 Pei, “Transition in China?,” p.8 and Minxin Pei, “Q. and A.: Minxin Pei on the Future of Communist Rule in China,” Interview by Michael Forsythe, *The New York Times*, February 29, 2016, available at <https://www.nytimes.com/2016/03/01/world/asia/china-pe-minxin-communist-party.html>.

101 As described in Edward D. Mansfield and Jack Snyder, “Democratization and War,” *Foreign Affairs* 74, no. 3, May 1995, pp. 79-87.

pollution. The hyper-nationalist version of China's history will be challenged by those who acknowledge the crimes of the CCP and reject its distorted and exaggerated historical claims. A regime obsessed with survival and fearful of containment and subversion will be replaced by one that is secure in its legitimacy and no longer fears that the democracies are attempting to encircle and overthrow it. Meanwhile, because they are less likely to see it as a threat, other democracies will be more inclined to trust China, cooperating with it to resolve outstanding disputes, perhaps including even the long-standing stalemate over Taiwan.<sup>102</sup>

As remote as the prospect presently appears, and as challenging as it may be to manage, there can be little doubt that a democratic transition offers the best hope for a "happy ending" to the strategic, economic, and ideological rivalry that is now gathering force between the United States and China.

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<sup>102</sup> This paragraph is drawn from Aaron L. Friedberg, *A Contest for Supremacy: China, America and the Struggle for Mastery in Asia* (New York: W.W. Norton, 2011), pp. 250-1.



## APPENDIX D

# China's Economic Futures in 2035

**Julian Snelder**

### Introduction

In early 2012, the State Council, China's paramount administrative authority, approved the release of *China 2030*—a bold vision for the nation's economic reforms. Co-authored with the World Bank, the document seemingly marked a definitive shift in China's policy direction toward the market. The nation would “rethink the role of the state and the private sector,” and foster an “open innovation system with links to global R&D networks.” It would pursue green growth and promote social protections. And China would “improve fiscal sustainability” and “continue its integration with global financial markets.” The 500-odd page report was acclaimed in the foreign and domestic media alike.

Today, *China 2030* is rarely mentioned. There was, instead, a decisive shift in another direction. What changed was Xi Jinping's ascension just months later, to centralize personally all of China's levers of power. Economic reform remains a critical national priority in China, but Xi has a totally different conception of what reform means. He did indeed rethink the role of the state in the economy, and the role of the Chinese Communist Party (CCP) in the state, but not in the way that many hoped. The authorities have intervened heavily in financial and capital markets, especially since 2015. Innovation has become decidedly parochial, with a quest for “independent self-development” in “secure, controllable core technologies.” And Xi pursued a ruthless purge of generals, officials and businesspeople to curb financial excesses and corruption—his priority for social justice. His bold political actions have notably diminished the State Council too. *China 2030*, its grand economic blueprint, has been cast aside.

Especially in light of that document's unexpected demise, the years to 2035 are unpredictable. To put in context, the *China 2030* report came less than twelve years after WTO accession launched China towards superpower status. Very few observers foresaw in 2001 how powerful its economic rise would be. Within the first dozen years as a member of the WTO, Chinese exports grew 850 per cent. In 2009, China confidently withstood the largest U.S. financial crisis since the 1930s. Indeed, that year was a pivotal moment in Beijing's self-perception of its ascent. The next dozen years will surely see slower Chinese growth but will be no less eventful than the preceding era. Xi has been a surprise to many observers, though perhaps less so to those carefully studying the country's political trendlines. As this chapter will explore, there are a number of challenges, constraints, and opportunities that now confront both China and its trading partners globally.

## Dimensions of Chinese Economic Trajectory

Any forecast of China to 2035 needs to account for Xi Jinping. Whether or not he stays in power until then, his policy legacy will remain influential. He has articulated a vision along three broad dimensions: the management of China's economy, China's political organization, and China's role in the world. In a nutshell, Xi Jinping Thought means economic stability, Party command, and global influence. Scenarios of China's economic future must consider how Xi's doctrine is implemented, and whether it might be deflected or interrupted by market realities, internal contradictions and the outside world. It should be noted that these dimensions are not entirely independent of each other (i.e., they are not "orthogonal"); so that a dominant driving force in one dimension is likely to influence pathways of the others. It follows then, that some scenarios are more probable than others.

### Dimension 1: Economic Dynamism

The future trend of China's economic growth, and its sustainability and stability, is a contentious topic among forecasters. China is already the world's largest economy measured by PPP GDP, with 18 percent of global output. Hypothetically, if China were to continue growing at its current rate of 6.5 percent, it would account for one-third of world output by 2030. It would be double the size of the U.S. economy. Though arbitrary, the 6.5 percent figure has been targeted by Xi until at least 2021 as a political goal. The IMF forecasts that China will continue growing relatively quickly at 5.5 percent by 2023, but with the warning that its "excessive, debt financed investment" must be addressed.<sup>103</sup> Since 2008, the ratio of non-financial sector credit to GDP has risen by well over 100 percentage points, bringing China close to OECD debt levels and substantially above emerging market peers.

Predictions of a financial crisis remain a minority view for now. Beijing has ample resources—notably a near-50 percent savings rate sequestered inside a highly restrictive

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<sup>103</sup> "IMF Staff Completes 2018 Article IV Mission to China," International Monetary Fund, May 29, 2018, available at <http://www.imf.org/en/News/Articles/2018/05/29/pr18200-imf-staff-completes-2018-article-iv-mission-to-china>.

capital account—from which to draw. Past prognoses of pending economic collapse have been falsified. The pessimists have consistently overlooked the political priority placed on stability. Xi Jinping, probably even more than his predecessors, will do “whatever it takes” to avoid a sharp recession. Instead, a more likely outcome, and still an ominous one for Beijing, would be a steady deceleration of GDP growth through the 2020s. Debt, both official and hidden, might continue to accumulate rapidly if investment efficiency deteriorates.

There have long been doubts about the accuracy of Chinese economic and financial data. There are a few reasons for this: the legacy of Soviet-style production targets, the inter-provincial “growth tournament” incentives that arise from political competition within the Party, and a lack of checks and balances such as statistical audits. The suspicion is that bad news tends to be suppressed or manipulated in such a system, and that economic performance may not be as impressive as advertised. This criticism is probably too harsh: there is some evidence that in the go-go years of the 2000s China had been understating actual growth, perhaps to prevent “bubbles” of excessive anticipation forming (say, in the housing market and in the currency). The surest sign of data manipulation is that Chinese economic statistics are unnaturally “smooth” and precise, with almost none of the volatility that other large countries experience in their business cycles. The data series are published extremely promptly, can be released and terminated arbitrarily and abruptly, and are seldom revised as is standard practice elsewhere.

In any case China is undergoing a moderation in growth that would be typical of an economy at its current level of development. Whereas public targets of 7–8 percent real annual GDP growth were the norm a few years ago, Xi Jinping’s administration has acknowledged that 5–6 percent is to be expected in the near term. This is almost certain to slow further and may already be below this trend range. The rapid accumulation of debt in recent years will impose an increasingly stringent burden on true underlying growth. On a more pessimistic view China might be growing at only 2 percent by 2030.<sup>104</sup> It would still be 50 percent larger than the United States by then, but with four times the population China would remain much poorer per capita and be caught in the dreaded “middle-income trap” of stagnating productivity.<sup>105</sup>

Productivity is already declining quite rapidly. China’s growth is extensive, reliant on ever-increasing amounts of capital and labour. Total factor productivity (TFP), from which long-term growth must be derived, has been timid. This is especially problematic because demographic trends are now adverse. Xi inherited a nation at “peak toil,” with the working age population reaching its zenith in 2015. Strikingly, the flow of school leavers (i.e., new entrants to the workforce) will halve by 2030. Even earlier, in 2028 China’s total population

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104 Frank Tang, “China’s economic growth story will be cut short under Xi Jinping, research firm predicts,” South China Morning Post, May 14, 2018, available at <http://www.scmp.com/news/china/economy/article/2145938/chinas-economic-growth-story-will-be-cut-short-under-xi-jinping>.

105 “The middle-income trap has little evidence going for it.” *The Economist*, October 5, 2017, available at: <https://www.economist.com/special-report/2017/10/07/the-middle-income-trap-has-little-evidence-going-for-it>

will peak. Chinese leaders face the imminent prospect of diminishing raw inputs to national power.

There is, however, a tremendous opportunity for the Chinese economy deriving from its technology sector and it could be a global game-changer. China's information and communications technology (ICT)-intensive sectors, many of which are privately owned, have world-class capabilities in certain areas. ICT firms contribute about one-third of China's growth but fully 150 percent of TFP growth, allowing the economy "to compensate for heavy productivity losses caused by persistent misallocation of capital resources, and the inefficiency of sectors in which the government has intervened."<sup>106</sup> No surprise, then, that Xi Jinping places so much emphasis on China's technological and industrial upgrading initiatives like *Make in China 2025*. He has identified advanced technology as a source of sustainable intensive growth, national prestige, and security. China will invest trillions of dollars on R&D alone between now and 2030, in an all-out effort to surpass the United States and other advanced economies.<sup>107</sup>

It is no exaggeration to say that technological success or failure could determine whether China maintains fast GDP growth or stumbles into the middle-income trap. Xi is also making two other bets: that government and Party intervention can enhance rather than impede China's economic institutions and its innovation efforts; and that this is not just a domestic initiative but a worldwide mission to further China's image, influence, and interests. These two projects—institutional and international—are the second and third dimensions.

## Dimension 2: Institutional Characteristics

Under Xi Jinping's leadership there has been a notable ideological shift in the organization of the economy. To liberal observers, this may look regressive. To Xi, however, his reforms are possibly a matter of survival, not just a preference. He has placed the highest importance on the primacy of the Party over all facets of Chinese society, including the economy. Under Hu Jintao, the phenomenon of *guojin mintui* ("the state advances, the private sector retreats") was already well underway. Under Xi, it has accelerated. The state's share of fixed asset investment has crept back up from 30 percent to 40 percent.<sup>108</sup> State-affiliated firms enjoy 80 percent of new lending by the formal banking sector; indeed the private sector's

106 Harry Wu and David Liang, "China's productivity performance revisited from the perspective of ICTs," Vox EU, December 9, 2017, available at: <https://voxeu.org/article/china-s-productivity-performance-revisited> and Dexter Roberts, "This is China's Real Economic Problem," Bloomberg News, July 13, 2017, available at: <https://www.bloomberg.com/news/articles/2017-07-13/this-is-china-s-real-economic-problem>

107 Hal Sirkin, Justin Rose, and Rahul Choraria, "An Innovation-Led Boost for US Manufacturing," Boston Consulting Group, April 17, 2017, available at: <https://www.bcg.com/publications/2017/lean-innovation-led-boost-us-manufacturing.aspx>

108 "China Fixed Asset Investment: YTD: State-Owned and Holding Enterprises, 2004–2017," CEIC, available at: <https://www.ceicdata.com/en/china/fixed-asset-investment-enterprise-and-work-type/fixed-asset-investment-ytd-state-owned--holding-enterprises>

share has shrunk by 80 percent since 2013.<sup>109</sup> Unsurprisingly there is a pervasive perception that state dominance is now the principal objective of Beijing's industrial policy.

Xi has promoted "supply side reform," to reduce the industrial overcapacity for which bloated SOEs are often responsible. Yet his objective is not to shrink SOEs but to merge them and "make them bigger and stronger." More significantly, the state itself has ceded power to the Party in the management of the economy. To many senior government functionaries, most of whom are Party members, the distinction was always somewhat artificial. But for SOEs which aspired to professionalization over politicization, the rebirth of the Party-state-business "iron triangle" has been disorienting.<sup>110</sup> Xi has extended the Party's reach into private businesses, turning Jiang Zemin's doctrine, of inviting businesspeople into the Party, on its head. Xi promotes mixed ownership, or hybrid private-public shareholdings. Whether private firms welcome such arrangements is unclear; few would dare to protest. As the U.S. government targets China's trade practices, its technology companies (and Huawei in particular) have become vocally more resistant and even nationalistic. In the "new era" of Xi's rule, being closely aligned to Beijing can be lucrative, if not a matter of survival.<sup>111</sup>

Nonetheless, there are powerful counter-currents against the apparently inexorable fusion of politics and business in China. Although the public share of national wealth is far above western countries at 30 percent, it has declined from 70 percent since Deng Xiaoping's reforms commenced.<sup>112</sup> China's private firms have expanded far faster than SOEs; their returns are roughly twice as high despite (or because of) receiving less capital from the state-dominated financial system. The most dynamic companies in China are all private, many of which grew in the cracks or in the shadow of the state. Privately founded internet firms now challenge SOE incumbents in financial services where the state formerly enjoyed a monopoly. The security-defense sector is being out-innovated by nimble start-ups in areas like surveillance and autonomy.

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109 Nicholas R. Lardy, *The State Strikes Back: The End of Economic Reform in China?* (Washington, DC: Peterson Institute for International Economics, January 2019); Lardy, "Xi Jinping's turn away from the market puts Chinese growth at risk," *Financial Times*, January 15, 2019, available at: <https://www.ft.com/content/3e37af94-17f8-11e9-b191-175523b59d1d>; and Tom Mitchell, Xinning Liu, and Gabriel Wildau, "China's private sector struggles for funding as growth slows," *Financial Times*, January 21, 2019, available at: <https://www.ft.com/content/56771148-1d1c-11e9-b126-46fc3ad87c65>

110 Houze Song, "State-Owned Enterprise Reforms: Untangling Ownership, Control, and Corporate Governance," Paulson Institute, December 4, 2017, available at: <https://macropolo.org/analysis/state-owned-enterprise-reforms-untangling-ownership-control-corporate-governance/> and Kjeld Erik Brodsgaard, "Can China Keep Controlling Its SOEs?" *The Diplomat*, March 5, 2018, available at: <https://thediplomat.com/2018/03/can-china-keep-controlling-its-soes/>

111 Sebastian Heilmann, "How the CCP embraces and co-opts China's private sector," *Mercator Institute for China Studies*, November 21, 2017, available at: <https://www.merics.org/en/blog/how-ccp-embraces-and-co-opts-chinas-private-sector>

112 Facundo Alvaredo et al., 2018 World Inequality Report, World Inequality Lab, 2017, available at: <http://wir2018.wid.world/executive-summary.html>

Despite their professions of loyalty, even “red entrepreneurs” might resent the subservience of their “patron-client relations” with the government.<sup>113</sup> Beijing has targeted some of the entrepreneurs with high profiles overseas, increasing foreign concerns about PRC intentions and reliability. Party cells now penetrate into all multi-national corporations operating in China and in large Chinese firms overseas. This creates a perception amongst foreigners that all Chinese business is Party-connected. The Belt and Road Initiative, to take one important case, is a distinctly state-led endeavour, which limits its appeal to some partner countries. Yet SOEs have been talking once again of “going out” and bolstering their international role. China, Inc. is on a commercial collision course with the rest of the world.

### Dimension 3: International Openness

China’s negotiation with globalization will be a third critical driver of its economic trajectory. Xi Jinping envisages his nation to be the indispensable economic actor by 2035. As the world’s largest trading power, and the top trade partner to more than 120 countries, China already has a fair claim. And the desire for openness is sincere; the lesson Chinese leaders draw from history is that insularity and autarky brought eventual calamity upon their nation. The question is not whether the economy will continue to globalize, but *how*. Today, “globalization with Chinese characteristics” is contended, selective, and asymmetrical. Is a much more broadly open China possible or likely by 2035? With its regular pronouncements of “opening to the world,” Beijing enthusiastically embraces opportunities and ideas abroad, yet carefully regulates foreigners’ activity at home.

Global trade has been an extraordinary success story in the modern era and, arguably, no nation has benefited from it more than China. Indeed, to a large extent, the root cause of current disputation over trade—and the WTO itself—is China’s perceived outsized gains within it. The rules of trade, and who sets them, are now at stake. Key characteristics of China’s trade are:

1. A huge dependency on imported resources,
2. An increasingly valuable role in the Factory Asia supply chains,
3. A sophisticated export slate, and
4. Increasingly deep and diverse bilateral relationships outside its traditional main trading partners in the West.

The composition of these four trends could shift significantly by 2035, depending on geopolitical developments. Trade invariably involves geopolitics. China is influential in many developing countries because it buys resources from them and has longstanding geopolitical solidarity with some. On the other hand, antagonism with rivals, especially with the

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113 David Kelly, “Reining in Red Entrepreneurs,” East Asia Forum, January 26, 2018, available at: <http://www.eastasiaforum.org/2018/01/26/reining-in-red-entrepreneurs/>

United States, arises from complaints about Chinese statecraft, industrial policy and the practice of mercantilism (prioritizing exports). A mercantilist country produces more than it can consume and saves more than it invests, thus it exports goods and capital. Such nations (e.g., China, Japan and Germany) may not deliberately pursue external surpluses. Instead the surpluses arise from conditions within, such as an aging and thrifty society or unusually competitive firms. Yet whatever the cause, history shows that imbalances can generate trade tensions; and these may spill over to other arenas.

The election of Donald Trump, an avowed “deficit warrior,” in the 2016 U.S. presidential election may prove to be a historical pivot point in global trade relations. His administration has attempted to use blunt instruments such as tariffs on Chinese imports as a negotiating tool to force a wholesale change in China’s political economy and thus to rectify America’s massive bilateral imbalance with China. Arguably the greater damage to the economic relationship will come from Washington’s deeper structural attempts to counter what it sees as Chinese expansionism and exploitation of trade globalization. Frictions are likely to continue and expand in the decade ahead. In particular, the WTO is seen by many Americans as inadequate in policing irregular trade practices such as explicit and hidden financial subsidies, involuntary transfers of knowhow imposed on foreign multinationals operating inside China, asymmetric market access (particularly in services), and favouritism towards local and especially state-owned Chinese firms. Thus the United States in turn is certain to impose tighter restrictions on bilateral R&D collaboration involving firms and individuals, technology licensing under export control laws, and a greater emphasis on reciprocity in trade dealings. Beijing sees such actions as American “containment” of its natural economic rise, antithetical to the multilateralism principle of the prior era.

Yet to a large extent, the underlying driver of China’s trade profile is its financial system, which remains repressive, i.e., encouraging savings and investment, generously feeding SOEs with funding, while regulating capital outflows. Until such conditions are relaxed, and both Chinese and foreigners are free to move money in and out of the country, a true Chinese reserve currency is a long way off. Despite perceptions that China is “buying up the world,” its overseas investment actually has been small relative to its muscular trading profile.<sup>114</sup> China is everywhere, yet in most places its footprint is light. Its offshore positions were traditionally focused on securing resources; the emphasis now will be on acquiring foreign technology to boost economic upgrading. Whether other countries are willing to allow such acquisitions and innovation exchange will be a key scenario driver. The regulation of information flows (currently highly restrictive in China) and the mobility of people will be other

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114 China Power Team, “Is China the world’s top trader?” China Power Project, Center for Strategic and International Studies, March 28, 2019, available at: <https://chinapower.csis.org/trade-partner/>

important factors. There are estimated to be 40 million “overseas Chinese” but less than one million foreign nationals residing in the PRC.<sup>115</sup>

## Prospects, Probabilities, and Pathways

China’s economic futures therefore will involve different permutations of these three drivers or dimensions. Put in simple binary terms:

- Will China experience high **economic dynamism** via technological innovation, *or* will it succumb to some form of middle-income trap?
- Will its economic **institutions** be CCP-dominated, *or* will China allow the leadership of private enterprise?
- Will China **open internationally** across a broad range of economic sectors, *or* will it remain relatively insular and selective in its international interactions?

Because China will likely be the world’s largest global economy in 2035, the outcomes are highly consequential. If it succeeds in technological upgrading, say, it makes a difference whether it pursues this goal via state or private firms. If it opens globally, the ownership and control of its economic institutions will determine how it trades and invests in the world. But as noted earlier, these dimensions are not entirely independent/orthogonal. This creates path dependencies, where starting points matter. China may be more likely to grow rapidly if it embraces markets, more likely to be accepted globally with a smaller role for the CCP, and more likely to be economically successful if it is fully open. Yet such an outcome—open, private-led, *and* dynamic—is *not* most likely, given Xi’s stance today. Actually, the opposite prospect, of a parochial, state-dominated, and stagnating China, is assessed to be higher.

That’s because the Party probably won’t relinquish its grip over the economy *unless* it experiences crisis, the very outcome Xi Jinping is committed to avoiding. And with the Party in command, it is hard to imagine the economy being truly open to flows of capital, people, and information. So while there is every reason to believe an open and private-led China would flourish, that pathway might be blocked if, or because, the Party won’t yield. Because the starting point today is a powerful Party with an ideologically committed leader, Beijing probably will try to do “more of the same” rather than change radically. Facing turmoil, it would initially double down on control, rather than reverse course and liberalize. Instinctively it might tighten external interactions and husband China’s economic powers at home. Indeed, it is worth asking: what, if anything, would make Xi Jinping change direction? And is it conceivable that such a shift could take place in the timeframe to 2035?

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115 Dudley L. Poston and Juyin Helen Wong, “The Chinese Diaspora: The Current Distribution of the Overseas Chinese Population,” *Chinese Journal of Sociology*, No. 2, pp. 348–373, 2016, available at: [https://www.researchgate.net/publication/307898102\\_The\\_Chinese\\_diaspora\\_The\\_current\\_distribution\\_of\\_the\\_overseas\\_Chinese\\_population](https://www.researchgate.net/publication/307898102_The_Chinese_diaspora_The_current_distribution_of_the_overseas_Chinese_population)



TABLE 3: SUMMARY OF ECONOMIC SCENARIOS FOR 2035<sup>116</sup>

Economic dynamism	Institutional dominance	International openness	2035 Scenario descriptor
<i>P</i> > 15%-25%			
High	Party	Selective	Beijing Rules
Low	Party	Selective	Troubled Continuity
High	Private	Broad	Reformed Republic
<i>P</i> = 10%			
High	Party	Broad	Global Imperium
High	Private	Selective	Introverted Power
Low	Private	Selective	Stumbling Reformer
<i>P</i> < 5%			
Low	Party	Broad	CCP Dead End
Low	Private	Broad	Failed Opening

### Synopsis of 2035 Scenarios and Assessed Probabilities

Here is a brief summary of the five scenarios assessed to be most likely, of which the top three (principal scenarios A, B and C) will be examined in more detail.

**A. Beijing Rules (25%):** This is the trajectory envisaged by Xi Jinping and his planners today. China by 2035 is an advanced innovation power, globally oriented but ruthlessly controlled.

**B. Troubled Continuity (20%):** Xi remains committed to his statist, nationalist Party-led vision for the economy, but the economy hits its limits and experiences major crises well before 2035.

**C. Reformed Republic (15%):** Crisis forces an unexpected change in politics and China undertakes a dramatic shift to a greater private role in the economy and true openness.

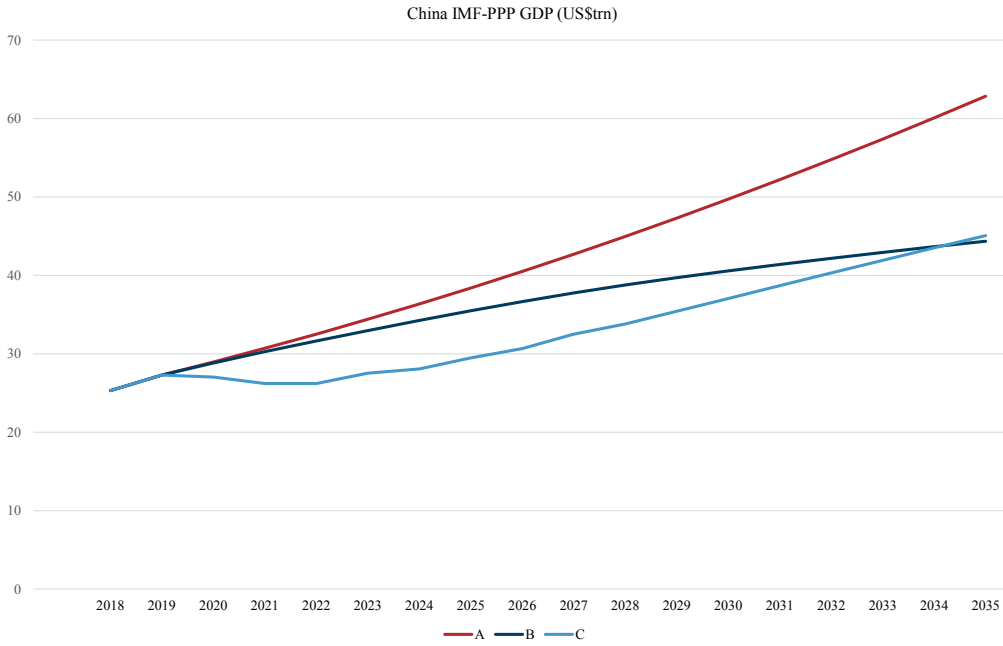
**D. Global Imperium (10%):** China rules “all under heaven.” Unchallenged, prosperous, and secure under Party command, it confidently opens to the world, at which it is now the center.

**E. Introverted Power (10%):** A “giant Japan,” China is rich, and the Party’s powers ebb and moderate as civil society grows strong. But China remains insular, as internal dynamics (like ageing) preoccupy it.

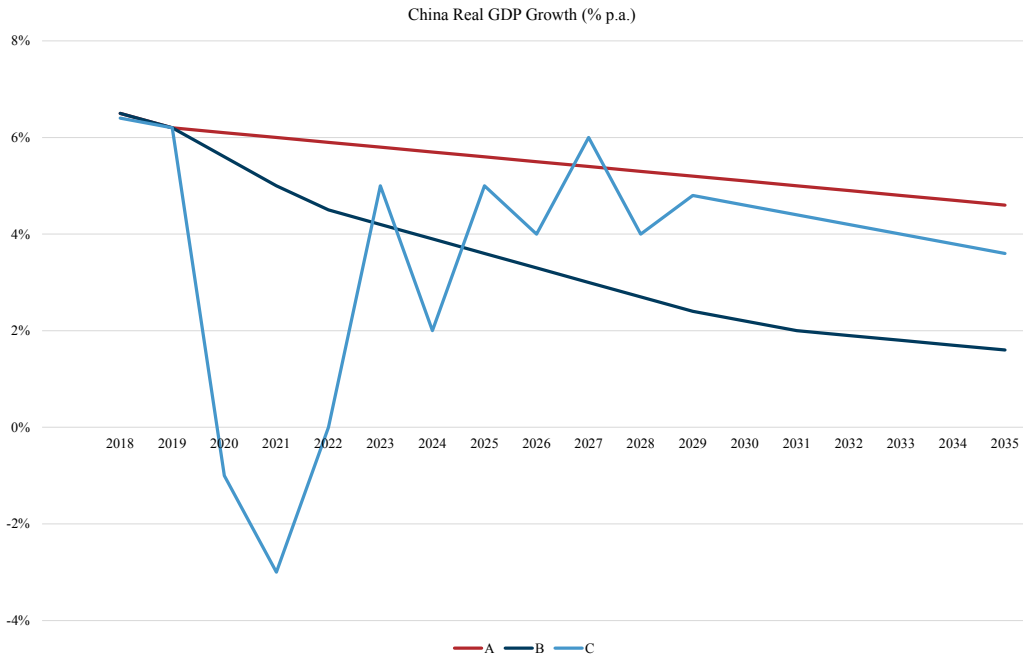
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<sup>116</sup> The probabilities indicated in this table are the judgements reached by the author and tested in the closed workshops undertaken as part of this project in both Washington and Canberra.

**FIGURE 11: GDP UNDER THREE PRINCIPAL SCENARIOS (A, B, C)**



**FIGURE 12: GDP GROWTH UNDER THREE PRINCIPAL SCENARIOS (A, B, C)**



## Principal 2035 Scenario Narratives

### Economic Scenario 1: Beijing Rules

Xi Jinping's vision for his nation's great rejuvenation is thoroughly vindicated by 2035. The now-elderly Xi starts to plan his retirement from official politics, though most expect him to rule behind the throne for many years to come. He sits atop a vast, highly centralized economic machine larger than the United States and the European Union combined. In economic terms, the world is as unipolar as it was after 1945. All major decisions are taken by Xi and the many committees ("Small Leading Groups") he chairs. Under his reign China is "the land of no surprises," with business cycles virtually absent and GDP continuing to rise at a near-5 percent clip through the 2020s. In economic matters he has been a conservative, confident and ruthless leader with a clear vision. Chinese citizens are justifiably proud of their steady gains.

The country is over two-thirds urbanized by 2035, and the gradual conversion of rural migrants to city residencies has lifted an additional half-billion people to the middle class. Chinese cities are as modern and developed as their counterparts in the western world, the mega-metropolitan areas even grander than Tokyo. And the construction goes ever on, well after the 2034 World Cup that will be Xi's triumphal valediction. Just replacing the aging structures of the 1990s and early 2000s means China dominates world markets for just about every category of material and equipment. Chinese companies are 300 of the global *Fortune 500*.

The once-maligned *Made in China 2025* industrial plan has spawned several notable new high-tech national champions. The nation is now dominant in the memory chip market, and its electric automobiles and consumer products are ubiquitous across much of the planet. Comac has launched its wide-body C929 airliner following the extraordinary sales success of the C919. Lavish state aid and subsidies means contracts are won everywhere. But the most significant and unique aspect of Chinese business is the fusion of collective and individual interests, led by the CCP. The state has mandatory minimum 10 percent shareholdings in all significant firms. Ideologically, China trumpets public-private partnership and Xi's "mixed ownership" model.

True, there are blemishes. National GDP per capita is still only half of America's and there remains a staggering gap between the city and the countryside. The number of Chinese over 65 now far exceeds the entire U.S. population. Perhaps more than anywhere else, China has struggled to find a balance between growth and equality. Civil society, atomized by the surveillance techno-state, does not demand a redistributive fiscal policy. Notwithstanding talk of harmony, China has become the most competitive nation on earth, with a scramble for elite education and scarce health- and age-care. Fertility, at 0.7, is the lowest ever seen. The superficially serene hybrid economy has been bought at a fearsome financial and political price. Aggregate debt is over 400 percent of GDP. The only thing that keeps the banking

system together is the persistently high savings rate of a stressed-out populace toiling inside a firmly-closed capital account.

It is the international arena which presents the greatest challenges. Chinese money is everywhere in the developing world by 2035, with several trillion dollars of investment placed in a de facto “yuan bloc” of almost eighty countries substantially dependent on Beijing. If any nation is global leader, it is China, yet it has not really become a global citizen. Its companies are distrusted because of the pervasive (and no longer hidden) Party role. Its connectivity networks spread widely—railways, roads, electricity—but the benefits have flowed mainly to local elites and the large clusters of expatriate Chinese in these communities. Richer nations fear (and usually reject) Chinese money and technology; poorer ones accept, but with misgivings.

This has created a cycle of resentful nationalism within China feeding tensions with other large states. America’s pursuit of a narrower self-interest (“nation-building at home”) and the European Union’s dissolution during the 2020s certainly did not help; these powers left the field open for Beijing to divide and conquer the world economy. Now that China has the run of the WTO and much of the UN, protectionist Western complaints look like sour-grapes hypocrisy to most Chinese. Economic relations with the United States and India are tense and are barely more cordial with Europe. Even Russia, still reliable under Putin, has seen protests against PRC investors. Academic exchanges have virtually dried up; China sends “only tourists to the West, and only businessmen to the South.” As the Chinese become self-sufficient in technology and ever more confident in their culture, they see less need for external ideas or capital. Instead, they are interested in exporting their China Model to the world.

## **Economic Scenario 2: Troubled Continuity**

It has been a difficult and tumultuous decade and a half for China’s economy, but Xi Jinping has kept his nerve and remained steadfast to his ideological orthodoxy: *The Party always comes first*. While never veering into outright crisis, in the early 2020s the economy and financial system reached a point from which recovery would need a radical change of direction. But U-turns were never Xi’s style. Confronted by an interminable barrage of trade war attacks from the U.S., Xi would not bend, batting back reciprocal measures in a tit-for-tat struggle. When American restrictions in technology, investment and finance were imposed, he doubled down on self-sufficiency and solidarity with China’s many Belt & Road partners. At every challenge he would move aggressively to rectify and reinforce the Party-state system in one area or another, “not to break it but to strengthen it.” Yet the emphasis on stability after 2020 was essentially remedial and reactive in nature. Crucial momentum and precious leadership time was lost, which otherwise could have been dedicated to advancement. Xi never flinched from external clashes nor broach any challenge to his authority, yet his appetite for economic risk at home was timid.

In hindsight, 2015 hinted at what was to come. A rising stock market, enthusiastically dubbed the “Xi Jinping rally” by the state media, corrected violently in the middle of that year, severely embarrassing him. Weeks later, central bank officials quietly made small tweaks to the exchange rate, triggering an avalanche of capital flight and panic about a large forthcoming devaluation. Trillions of dollars of precious wealth were lost before the situation was stabilized. Xi drew three conclusions from these events: never trust markets, never depend on them, and keep them firmly under control. From then on, China’s grand global financial liberalization project was put on hold, if not killed outright. On the other hand, the domestic credit spigot was opened, fuelling a sustained increase in housing prices and technology investing, and so stimulating the next bubble. As China’s “great ball of money” rolled from one asset class to another through the 2020s, regulators were forced to chase it. Mindful of 2015’s social anger about financial losses, the leadership responded by injecting ever-more funding into the system.

When the mechanism for allocating capital, the economy’s most important factor, is thus impaired, eventually the efficiency of the real economy is harmed. As credit/GDP continues to spiral upward, investment efficiency weakens further, and banks are saddled with soaring non-performing assets. Bank capital is tied up quietly supporting zombie companies (usually SOEs) because the alternative is to recognize the problem, which is politically unacceptable. A greater share of economic income is consumed as non-productive interest. Japan was able to keep its high debts affordable, with interest rates near zero. But the Japanese were comfortable “exporting their money home.” By contrast, Chinese money has always been anxious to escape, so it demands a higher interest rate. Capital flight will be a critical indicator of stability.

Looking back at the last 15 years, China’s technology sector was quite a success story, at least in certain areas. Yet it must be remembered that technology wreaks “creative destruction,” and a lot of good white-collar jobs were lost when automation and AI were adopted en masse. All those urban online conveniences require lowly-paid deliverymen and drivers, keeping much of the workforce down and anxious. And when China needed core technologies, such as semiconductors, these turned out to be more difficult to develop than expected, because foreigners became highly protective of their intellectual property, especially as the endless fights with America rumbled on into the 2020s. In hindsight, the twenties will be seen by technocrats as a lost decade.

In 2035 the Party under Xi is stronger and more centralised than ever. Several financial crises have hardened the system. The experience of 2015, where bankers were arrested for “being on the wrong side of policy” set the precedent. Every macroeconomic failure thereafter results in the purge of a new set of high officials, usually on corruption charges. While popular with the public, such punitive measures reduce bureaucratic incentives for risk, which ultimately exacerbates the underlying dynamism problem. The CCP has a fierce grip over commerce. Even the captains of China’s private sector, the tech CEOs, have by 2035 long since surrendered effective control of their companies to Party committees. Their firms

are too big and important, playing an irreplaceable role in the social monitoring and stability maintenance apparatus.

Rule by fear hasn't made Xi's China popular overseas, except in hard-core authoritarian societies. Western countries maintain tight controls over their economic dealings with China. Perhaps to distract the masses from their shrinking paychecks, Xi himself has resorted repeatedly to nationalist fury about foreign "containment." This never fails to rally his subjects. Ironically though, as Chinese growth has faltered and fallen towards a 2–3 percent rate closer to their own, rival countries have quietly become less anxious. While authoritarian, angry, and alien to many, China is a noticeably ageing superpower by 2035 and is less threatening economically than the new challengers arising across Eurasia and Africa...

### **Economic Scenario 3: Reformed Republic**

No one can be sure of the exact circumstances of Xi Jinping's unexpected retirement in 2024. Officially, it was for health reasons, but the economy was surely a factor. As the global trade war entered its sixth year, China's economy was badly bruised. Overcapacity, bankruptcy, and unemployment reached the levels of the 1980s and 1990s when cradle-to-grave communism was abolished. When the WTO imploded in 2023 (it had become toothless long before then) to be replaced by the "noodle bowl" of hard-fought bilateral deals, so did China's bargaining position weaken. It is, after all, a major surplus country, exporting much more than it imports, and needs markets abroad. Xi's strident negotiating style, especially his insistence upon "information sovereignty" and on the PRC being designated both a developing country and a market economy, was seen by many as a chief reason for the WTO's demise. Xi's early anticorruption purges had made him many enemies inside the Party. China's urban middle class saw the global drawbridges being pulled up, and with their access to overseas properties, holidays, and schools denied, they voted with their feet and bank accounts. That was when the politics turned.

It must have pained Xi to see the reversal of his life-long doctrine, but by then the state's finances were desperate. US\$3 trillion in foreign exchange reserves seemed a grand sum in 2020, but it covered only eight months of imports, and capital outflows soon forced the central bank to loosen regulations, devalue the *yuan* and seek private capital direct into the banks and insurers. Several trillions of dollars (a multiple of the entire amount raised to recapitalize U.S. banks after the 2008 crisis) would be privatized. It was like "IMF therapy," although of course China would never allow the IMF's intrusion into its sovereign affairs, nor even the word "privatization." The new equity would be known as "social capital" and most of it came from China's most powerful corporations, many of them private companies like the technology and real estate giants. Some banks and insurers had backing from foreign financial funds. Yes, it was an "oligarchic" process—the very ending of the USSR that Xi sought to prevent from recurring—but at least the CCP did not fall from power the way the CPSU did.

China thus entered its robber-baron age, an era of huge corporate conglomerates with banks at their hearts. It took a remarkable ideological metamorphosis for the CCP to preside over such a concentrated network of capitalism, but it adapted exceedingly well. The mandarins are the ultimate pragmatists. The Party keeps Big Business in check with its control of the courts and, in return, the tycoons keep the economy humming and harmonious. The Party oversees the state's residual shareholdings, which are colossal but passive. And the Party retains control over the PLA, of course, and that is its real insurance policy.

This arrangement may appear unlikely (and unstable) to Westerners. However, it is not very different from what Taiwan looked like after the KMT was ejected from the mainland. Miracle-era Japan reconstituted the pre-WWII *zaibatsu* into the huge financial-industrial complexes known as the *keiretsu*, which sought the patronage of the perennially-ruling Liberal Democratic Party. Korea separated finance and industry, but its industrial *chaebol* were direct beneficiaries of the Democratic Republican Party's industrial policy. Arguably there is no more irony in the "communists" ruling this China in 2035 than "liberal" and "democratic" parties ruling East Asia after WWII. Those states were not particularly liberal nor democratic, they just happened to have the support and tutelage of the United States.

China in this scenario may be liberalizing in a fashion, but it is decidedly illiberal. Indeed, some outsiders were initially hopeful that this new hybrid-capitalist China would become democratic. But the United States was too distrustful, too wary of the post-USSR experience with Russia, and too distracted by its own problems at home to encourage such a process. The *yuan* devaluation was the nail in the coffin for the WTO. And with the WTO lying in ruins, how much credibility does Western leadership have anyway? From Beijing's perspective, although China suffered a devastating crisis in the early 2020s, the collapse of the WTO turned out to be a blessing. As the newly dominant global commercial power, it was able to rewrite the rules from the ashes, crafting favourable bilateral deals with its many trading partners.

And the China Crisis of the early twenties yielded far deeper benefits than were anticipated in the pain of transition. The commercial sector, now "under new management," generated rising dynamism and lifted growth rates back to a respectable 4 percent in the latter half of the decade. The shattering devaluation and capital account loosening ultimately allowed a free market for the yuan that generated sizeable inflows into China and provided the foreign exchange for China to invest massively abroad: some \$10 trillion by 2035, rivaling American outward direct investment. The yuan was still far from being a true reserve currency, but 25 percent of global trade transactions were settled in it.

Most importantly, trade boomed because the key Chinese economic actors were now charismatic private entrepreneurs rather than SOE *apparatchiks*. By 2035 Chinese technology is ubiquitous, and its soft power is soaring. The Chinese currency floats more-or-less freely, and the financial markets seem to function normally, which has largely neutralized Western criticism of Chinese mercantilism. To be sure, China remains a messy, opaque, and corrupt society and the private-public character of these hybrid companies creates suspicion of

collusion and unfair state support. But they are undoubtedly impressive and they are gaining global share at the expense of multinational firms. With the WTO defunct, it is harder for other countries to object to Chinese practices. Many outsiders wanted a market-driven, open, private-led Chinese economy, as envisaged by that long-forgotten World Bank document *China 2030*. As this outcome unfolds, they've started to regret what they wished for.

## Conclusions and Implications

The principal scenarios described in this paper are based on probabilities and pathways that are seen as plausible today. What can we infer about China's economy in 2035? Starting with the obvious, it will most likely far exceed any other in scale: e.g., 50 to 100 percent larger than the United States across the three principal respective cases. Admittedly, some economists think that a major contraction in China's global output share is practically certain, eventually following Japan's example.<sup>117</sup> And with a large population, Chinese per capita income and capital stock will remain well below its more advanced peers.<sup>118</sup>

A severe crisis, as in the *Reformed Republic* scenario, would cost China \$10-20 trillion in permanent lost annual output by 2035 (relative to the continuing momentum of *Beijing Rules*). That matter of simple arithmetic must cause anxiety to the Chinese leadership as they race towards achieving maximal economic gains by 2035. Xi Jinping's "no-surprises" economic doctrine thus appears well-founded. Still, a major crisis may raise the prospect of renewed private dynamism, which could clawback lost economic potential. Arguably the *Troubled Continuity* scenario which steers between these extremes is a more dismal outcome, condemning China to indefinite statist stagnation. But from the Party's perspective, this might be preferable if it maintains absolute authority over national life.

In any case, the CCP will almost certainly remain highly influential in economic affairs. It is hard to imagine the Party surrendering its managerial and financial mandate over the "commanding heights" of the economy, except possibly in the event of major crisis. Of the three principal scenarios, even the post-crisis *Reformed Republic* might retain the Party as a shadow guardian, quietly supervising the private merchants through constitutional, administrative, and disciplinary mechanisms. In the others, the Party either leads the private sector or controls it outright. Party pre-eminence will be Xi's signature doctrinal legacy. He is not some radical aberration in Beijing's elite politics, but a robust exponent of the CCP's continuing will to rule. So, China seems destined to retain at least some form of hybrid party-state-private economy.

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117 "U.S. Should Chill Out About High-Tech China Threat, Pettis Says," *Bloomberg News*, June 6, 2018, available at: <https://www.bloomberg.com/news/articles/2018-06-06/america-should-chill-out-about-the-high-tech-china-threat>

118 Glenn-Marie Lange, Quentin Wodon, and Kevin Carey, eds., *The Changing Wealth of Nations 2018: Building a Sustainable Future* (Washington, DC: World Bank Group), 2018, available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/29001/9781464810466.pdf>



The “performance legitimacy” view popularly holds that the CCP’s mandate (originally derived from its “revolutionary legitimacy”) now rests principally on its ability to deliver stability and rising prosperity—thus a series of major financial crises could sweep it from direct power. This is essentially the premise of the *Reformed Republic* scenario. There is however another countervailing phenomenon, “nationalist legitimacy,” which is under-examined in the West. In this view, the Party not only has the gun, but broad popular support for its resolute defense of the national interest. This has real economic ramifications. It means that there is genuine enthusiasm for Xi Jinping’s quest to make China rich, powerful, and advanced. There is widespread approval of collectivist and mercantilist policies, and revulsion at the chaos and inequity that followed the USSR’s collapse. Even if Chinese growth falters, therefore, neither Xi nor public support for him are likely to waver. That is why *Beijing Rules* and *Troubled Continuity* are assessed to be most probable.

So even in a successful, open, nominally liberalized China, we should expect economic nationalism. Tensions with Western states will escalate as Chinese champion firms climb up the value chain, as was the case in 1980s with Japan’s automobile and memory chip industries. Furthermore, if China retains even a vestigial CCP-PLA complex at the core of its economy, China and the United States may enact control regimes on each other’s economies, restricting all dual-use technology transfers. Two of China’s three largest import categories (semiconductors and machinery) have been prioritized for domestic substitution by *Made in China 2025*; these categories also have military applications. That raises doubts about the future of international education and research collaboration. To be sure, China will remain open to receiving scientific knowledge, but whether it will reciprocate will depend on its governance and institutions. The statist or Party-dominated institutions will tend to hoard China’s growing innovation prowess. But an outward-looking, private-dominated China might be no less militaristic or nationalistic.

There is much debate to be had over this matter of “openness,” defined here as the unrestricted two-way flow of capital, people, and information. No nation is perfectly open nor is openness necessarily a good thing; it is meant in this context as a descriptive, not a normative, property. As long as the Party is in command, its requirements for control and stability probably will rule out China having high levels of factor mobility. But it is conceivable that it could succeed brilliantly nonetheless. In the *Beijing Rules* scenario, China would maintain tight controls and still expand globally by building a network of partners prepared to deal with China on those terms. Many developing states welcome Chinese money, technology, expertise and goods. If they wish to avoid Western financial channels, they can settle in commodities or in Chinese vendor credits. China could build a very sizeable geo-economic bloc along such lines. Other rising superpowers, have done this, as was seen with the USSR’s Comecon system. China, with its phenomenal savings rate and competent policy-lending institutions, would be far more dynamic than the Soviet bloc ever was and, by any definition, more open to the world.

The greatest test of China's economic openness relates to its capital account. There is an extreme monetary imbalance between China's huge domestic savings and the country's relatively small overseas net investment position.<sup>119</sup> This might only be resolved through a genuine financial liberalization, allowing Chinese citizens to freely export trillions of dollars, as they certainly wish to do. Mass emigration might follow. This could destabilize China's banking system, perhaps threatening Party rule. It would trigger a very large currency devaluation, supercharging Chinese exports, crushing other economies, and possibly dooming the current global trading system. Such a crisis might ultimately bring about the *Reformed Republic*. However, if China could bridge this tumultuous transition, it could emerge with a competitive parochial economy broadly in equilibrium with the rest of the world. The real question is: could the rest of the world deal with such a drastic redistribution of economic power, in which Chinese money, emigrants, firms and commercial practices prevail globally? Or is Xi's deliberate, controlled vision for economic supremacy actually preferable to rival states?

This leads to a final observation. Any view of the future must consider the reaction and response of other states; no nation is in complete control of its destiny. We have not seen such a rapid concentration of economic power since the aftermath of World War II, when much of the industrialized world lay in ruins leaving the United States as the richest and most advanced power. Although it is very large, China still faces considerable shortcomings in its development. More importantly, it faces increasing resistance from determined, sophisticated rivals who may balance against it more forcefully over time. Its economic outlook must be considered within an action-reaction dynamic. Chinese leaders have identified the period to 2030 as a "window of strategic opportunity" to make maximal gains not only in its domestic economy but also in geopolitics, geo-economics, and defense.

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119 "FDI Positions, main aggregates BMD4," Organization for Economic Cooperation and Development, available at: <https://stats.oecd.org/Index.aspx?QueryId=64238>

## APPENDIX E

# Primary Scenarios for China's Military in 2035

Toshi Yoshihara

### Introduction

At the 19<sup>th</sup> Party Congress in November 2017, Chairman Xi Jinping spoke of a “strong-military dream” he believes should propel military modernization and reform. To Xi, powerful ground, air, naval, and rocket forces represent key instruments of statecraft for advancing China’s national purposes. Military power also certifies China’s rising stature in the pecking order of international politics. As such, Xi pledged to build a potent military and set a timetable for China to turn aspirations into reality. In a three-step process, the People’s Liberation Army (PLA) will have: 1) completed the mechanization process and made substantial strides in “informationization” by 2020; 2) achieved complete modernization by 2035; and 3) “fully transformed into world-class forces” by mid-century.

While Xi does not define what he means by “world-class forces,” he presumably seeks a military equal to the best in the world, including the armed forces of the United States, Britain, France, Japan, and Australia. Even so, Xi’s ambitions are broad enough to allow the PLA to adapt and evolve along different trajectories. Would China emerge as a globe-straddling military power by mid-century? Or, would China be content or be compelled to confine its military prowess largely to the Asian theater? To answer these questions, this paper assesses two external driving forces that will shape the strategic balance in Asia and, based on these two drivers, develops four alternative futures for the PLA in 2035.

## Strategic Drivers and Alternative Scenarios

The first strategic driver is the future status of Taiwan. The self-governing island is a critical planning parameter for the PLA. Indeed, it defines the PLA's "main strategic direction," the contingency around which the Chinese military has organized and equipped itself and for which the PLA has planned for decades. Taiwan's future status would either free China from a high-intensity conflict that could involve the United States, Japan, and other third parties or it would continue to fixate Beijing's attention and consume China's resources in a potential offshore military campaign.

The second driver is the health of the U.S.-led alliance architecture in Asia. China has long viewed American alliances as a relic of the Cold War and a bulwark against Beijing's regional ambitions. China could find the alliance system in disarray and thus vulnerable to subversion and attack. Or, Beijing could see an overlapping network of relationships coalescing around the Chinese periphery, offsetting the PLA's strategic leverage.

The rationale for choosing these two drivers is to lend greater agency to and provide policy-relevant guidance for the United States, its allies, and partners in shaping the security environment, the strategic balance, and the PLA's choices. The scenarios will illustrate how action (and inaction) on the part of external players could have enormous consequences for the Chinese military and China's relative geopolitical power in the region and globally.

Based on variations in these two drivers, four potential scenarios emerge: 1) *PLA Straightjacketed* - Taiwan maintains its de facto independence while the U.S. alliance system revitalizes; 2) *PLA Unbound*—the alliance system fractures and Taiwan falls to China; 3) *PLA's Dream Postponed*—the alliance architecture breaks down and Taiwan stays out of China's hands; and 4) *PLA's Hard "ROC"*—Taiwan integrates with China while the allies coalesce.

In Scenario 1, the PLA finds itself trapped behind the first island chain. It must gird for a contingency against Taiwan even as it faces fierce pushback from other regional players and the United States. In Scenario 2, the PLA enjoys the most room for maneuver. It faces little resistance locally, opening strategic vistas across Asia and beyond. In Scenario 3, the façade of U.S. strength postpones Taiwan's fall and the PLA's global plans. In Scenario 4, the PLA would occupy a commanding position on Taiwan as it confronts a counterbalancing coalition. The following will describe the plot by which the PLA reaches its destination in each scenario and assess the implications for the PLA's force structure, posture, and strategy.

### Military Scenario 1: PLA Straightjacketed

In this scenario, Chinese self-aggrandizement—from maritime aggression in the East and South China Seas to political and economic coercion—awakens the United States and other regional stakeholders to the looming threat and triggers organized resistance. Local powers radically redefine their relations with Beijing, accepting rivalry as an inevitable outcome

of Chinese aggrandizement. They actively seek to counter the most dangerous elements of Chinese military power to thwart China's plans for regional domination. At the same time, Chinese bullying of Taiwan, including measures to coerce, isolate, and influence, is ineffective or backfires. Taipei stays defiant even in the face of Beijing's multi-pronged assault. Consequently, China's quest for reunion with Taiwan remains as elusive as ever while key regional actors embark on self-strengthening and cooperation with each other to counterbalance China's rise.

In the military realm, local players and the United States acquire the tools and skills to blunt the PLA's power. They deploy anti-access capabilities—ranging from submarines to coastal defense units—on the first island chain to hold Chinese forces at risk and to raise costs on a PLA offensive campaign. The United States and its allies shore up the resilience of their basing and logistical infrastructure. They take measures to harden, protect, and diversify important facilities, enhance dispersal tactics, and improve the ability to operate from austere bases across the Western Pacific. The introduction of longer-range striking power restores the offensive punch to U.S. and allied forces. At the same time, more effective air and missile defense systems and tactics drive up the costs of Chinese missile salvo attacks, while emissions control, electronic warfare, and other countermeasures severely complicate the PLA's ability to find and target allied forces.

China's assertiveness also prods local powers to form security partnerships and defense cooperation. Through the 2020s, bilateral, trilateral, and quadrilateral arrangements evolve into overlapping networks of allied relationships. These ties serve as a basis for a permanent combined task force composed of like-minded countries. Headquartered in Singapore, this coalition of the willing joins forces to enhance maritime domain awareness, share intelligence, conduct naval and air patrols, and engage in regular training and exercises. At the same time, U.S. and regional ties to Taiwan deepen to an unprecedented degree.

Allied countermeasures drive up costs sufficiently to render a Chinese first strike against Taiwan less attractive. They sow doubt in the minds of CCP leaders that a blitzkrieg campaign would successively knock out Taiwan, the United States, and other third parties. Instead, Beijing believes an attack on Taiwan would bring about a region-wide coalition that counts many of the largest and most advanced economies as its members. And, the prospects of a protracted war rather than a quick, decisive victory convince Party leaders that risks of aggression far outweigh the potential benefits. China thus remains obsessed about precluding Taiwanese independence and conducting operations to deter and, failing that, to defeat third-party intervention.

In terms of force posture, large elements of China's land-based strike systems, including missiles and aircraft, are still oriented narrowly toward a Taiwan contingency. A substantial portion of the Chinese navy's sea denial, sea control, and power projection forces are similarly arrayed against the island. The imperatives over the island impose an opportunity cost relative to other regional and global goals to which Beijing aspires. Consider the 1,200 short-range ballistic missiles aimed at the island and the associated costs of maintaining,

operating, manning, recapitalizing, and training those forces. They represent resources and capabilities that are tied almost exclusively to a fight over the island and are therefore unavailable for China's other military missions. In this sense, Taiwan constitutes a kind of tax, a growing tax in this scenario as the first island chain hardens against a potential Chinese attack.

Should deterrence fail over Taiwan, the PLA also faces simultaneously threats on two geographic fronts. It must entertain the possibility that its forces could be trapped behind the first island chain. If allied forces hem in the PLA, Chinese commanders must accept that attempts to break out of the island chain could result in grievous losses. The PLA must also worry that its forces operating outside the island chain could be cut off from the homeland and exposed to U.S. and allied counteroffensives. Indeed, Chinese naval flotillas in the far seas would confront opponents that excel at blue-water combat. Vulnerability to both anti-access forces in the near seas *and* open-ocean warfare in the far seas would undoubtedly shape China's risk calculus in this scenario.

With pressure mounting along its immediate periphery and in faraway theaters, Party leaders fall back on asymmetric, non-military options. Beijing employs political warfare and economic statecraft to soften up or otherwise intimidate neighboring democracies, foster regional and global perceptions of American decline and unreliability, and erode U.S. security commitments. China buys access to—and deploys weaponry to—ports, airfields, facilities, and bases across the Indian Ocean and the South Pacific to outflank U.S. and allied positions. Concurrently, the PLA wages “three warfares”—media, psychological, and legal operations—to impose costs on the revitalized U.S.-led alliance system and to undermine Taiwan's confidence in its own ability to resist China. In other words, unfavorable shifts in the strategic balance draw Beijing toward other areas of the long-term competition that are more promising for the United States and its allies and partners.

### **Military Scenario 2: PLA Unbound**

In this scenario, the United States fails to commit to a clear and sustainable grand strategy. There are lingering doubts about Washington's ability and will to sustain primacy in the Western Pacific and an aversion to choosing either: 1) a highly risky unilateral withdrawal from the region, or 2) a prohibitively costly open-ended strategic rivalry against China. Caught between these difficult choices, American statesmen punt on vital resourcing, modernization, and posturing decisions and muddle through. Sensing U.S. indecision, China steps up its militarization of the South China Sea, coercive posturing around the Senkakus, military exercises around Taiwan, and air and naval operations between the first and second island chains. None of these escalatory steps and predatory behavior, undertaken sequentially or simultaneously, trigger meaningful responses from the United States and its allies.

Meanwhile, as the strategic balance tilts toward China at an accelerated pace, U.S. allies engage in wishful thinking or cut the best deal they can with Beijing. Lacking the strength and confidence to strive for great power status and strategic independence, much less go

nuclear, Japan muddles through alongside Washington. The Philippines resigns itself to Chinese dominance in the South China Sea and appeases Beijing to head off further aggression. Taiwanese confidence similarly flags. But the island's leaders and citizenry still cling to the hope that the United States would come to the rescue should deterrence fail. In the meantime, the U.S. forward presence in Asia becomes increasingly irrelevant as an instrument of deterrence and reassurance. American alliances are gradually hollowed out by the absence of collective resistance against Chinese encroachments. Everyone is in denial, refusing to come to terms with the consequences of indecision and inaction.

On the 110<sup>th</sup> anniversary of the CCP's founding in 2031, Beijing issues an ultimatum, demanding cross-strait negotiations on the island's future status. The Party leadership signals that final preparations for the sacred task of reunification are well underway. Shortly thereafter the PLA engages in massive months-long exercises opposite Taiwan. In the meantime, China launches a concerted disinformation campaign through Taiwanese media and pro-unification political and business leaders on the island. Rumors planted by mainland operatives that the Taiwanese government was engaged in secret negotiations with Beijing on the terms of unification trigger a parliamentary investigation, a constitutional crisis, and political paralysis. As the pressure mounts, choices that were once inconceivable become thinkable. Given the cross-strait military imbalance, China's absolute power superiority, and American acquiescence, if not complicity, Taipei loses its nerve, backs into negotiations and ultimately rejoins the PRC under special administrative status.

In a post-unification era, the PLA is relieved of the burdens associated with fighting Taiwan and defeating the United States and its allies. Forces deployed for a cross-strait war become redundant or are freed up for other purposes. The PLA demobilizes certain units, redeploys capabilities to other fronts, stations garrisons on Taiwan, and sells excess equipment on the international arms market. For the Rocket Force, for example, the PLA retires older-generation, shorter-range missile systems while it redeploys some of its missile brigades to other border regions, including those near Korea, Vietnam, and India, stations missile units on Taiwan, and keeps some within range of Japan. The PLA restructures its air force and navy along similar lines, discarding older, short-range units that are no longer useful. As Beijing divests legacy systems and generates savings, it increases investments in long-range strike capabilities and general-purpose forces.

Untethered from Taiwan, a larger proportion of general-purpose forces and long-range strike systems becomes available to better defend its overseas interests stretching from the Bay of Bengal to the Mediterranean. While some elements of the Chinese navy remain in home waters, the seagoing forces, including carrier battle groups and nuclear attack submarines, are free to roam the far seas to support a range of global missions. The bases and access facilities established along the Indian Ocean littorals are further developed to sustain naval operations. From these locations, the Chinese navy maintains a sizable and permanent footprint across the Indian Ocean. The PLA's air and rocket forces redeploy their forces, including air expeditionary units, integrated air-defense systems, and antishipping missile

brigades, to these forward bases. These weapons extend shore-based cover to the Chinese surface fleet, forming an anti-access corridor through which Chinese fleets transit the Indian Ocean.

Such a forward posture furnishes China geopolitical veto power over events across the Indian Ocean. The PLAN begins to engage in latter day gunboat diplomacy to coerce local actors, demonstrate Chinese resolve, or shape extra-regional circumstances in Beijing's favor. For instance, China dispatches a carrier battle group to the Persian Gulf in a show of force. The largely symbolic deployment signals a major shift in the geopolitics of the Middle East. Washington and other global powers are compelled to factor in Beijing's strategic interests for the first time in a theater that was previously an exclusive Western preserve.

### **Military Scenario 3: PLA's Dream Postponed**

This scenario is a hybrid of the preceding two alternative futures. The same factors that lead to the hollowing out of the U.S.-led alliance system in Scenario 2 are at play, but the security architecture erodes more slowly, owing to the resilience of allied institutions and relationships. At the same time, the legacy of American dominance predisposes China to overestimate U.S. staying power while underestimating its own. Because U.S. security commitments to Asia and the integrity of the alliance system appear stronger than they really are, this façade of American power deters China and reassures allies longer than reality should have warranted. This gap between perceptions and realities of power buys the United States and its allies, including Taiwan, more time. By the late 2020s, however, Chinese assessments of U.S. power finally catch up with facts on the ground. By this time, Beijing is prepared to act against Taiwan. In other words, the slow pace of the unraveling simply delays the day of reckoning.

How China's coercive campaign against the island unfolds may depend on the Party's sense of timing. If Beijing hews to Xi's timetable for fulfilling the strong-military dream, then the Party uses the mid-century goal to judge whether it is behind or ahead of schedule. If the Party does not feel pressured to act sooner, then it is possible that Beijing follows the path summarized in Scenario 2: China probes U.S. and allied defenses, escalates tensions throughout maritime Asia, and intimidates weaker players in the region. By the mid-2030s or later, the absence of serious resistance leads Beijing to make the ultimatum to Taiwan summarized in Scenario 2. If, however, the Party believes that it must resolve the cross-strait stalemate to stay on schedule, then it may be inclined to take greater risks, including a limited military campaign to rapidly collapse the island's will to resist.

In terms of force posture, the PLA is still consumed by Taiwan in the early 2030s. Similar to Scenario 1, many of its forces are still organized for attacking the island and defeating third-party intervention. The transition to a more globalized posture as described in Scenario 2 is postponed until the island falls into Beijing's hands.



## **Military Scenario 4: PLA's "Hard ROC"**

In this scenario, Taiwan's weakening military position and diplomatic isolation as well as Chinese economic inducements and political coercion take their toll on the island through the 2020s. The military balance deteriorates further as the PLA's modernization progresses apace while the Taiwanese armed forces struggle to keep up. Beijing continues to squeeze the island's international space, further reducing Taiwan's few diplomatic allies. Chinese political warfare—including measures to corrupt legislative and policymaking processes, spread disinformation among the public, coopt influential constituents within society, and breed financial dependencies—eats away the integrity of Taiwanese state and society. Like Scenario 2, the island's hopeless situation forces its leaders to acquiesce to Beijing's ultimatum in 2030.

Following Taiwan's occupation, the PLA redeploys power projection and anti-access units to the island. Beijing fields anti-ship ballistic and cruise missile brigades, integrated air defense systems, long-range sensors, and airpower. It constructs submarine pens for its nuclear-attack boats and forward deploys a sizable contingent of surface combatants. Chinese commanders believe that they are well positioned to turn Japan's southern flank, dominate the north-south axis of sea lines of communications along the first island chain, better monitor and, if necessary, restrict air and maritime transport through the South China Sea, project power into the Pacific with less hindrance, and threaten the Philippines from the north.

In the meantime, the U.S.-led alliance system revitalizes along the path outlined in Scenario 1. Taiwan's collapse and its subsequent fortification further galvanizes the United States and its security partners to counterbalance Beijing. Japan redoubles its efforts to militarize the Southwest Islands, garrisoning potent anti-access units along the archipelago. The Philippines agrees to host the permanent presence of U.S. land-based maritime strike platforms on Luzon.

In this scenario, Taiwan remains a locus of Sino-U.S. strategic rivalry: China seeks to widen the breach along the first island chain while the United States and its allies attempt to confine, if not neutralize, the military threat on the island. Consequently, the counter-access competition intensifies across the East and South China Seas. Large swathes of maritime Asia become no-man's sea; neither side has the freedom to use the seas at acceptable cost in wartime. A new stalemate thus emerges over Taiwan. The extent to which the island ties down PLA resources will determine the pace and scope of its globalizing posture, as highlighted in Scenario 1.

## **Implications**

The scenarios above lead to two hypotheses that carry implications for the United States and its close allies. The first hypothesis is that China's strategic success on the global stage rests first on a favorable balance of power in its own backyard. Or, to put it differently, a security surplus along its immediate periphery is a precondition for obtaining Beijing's aims beyond the Western Pacific at acceptable risk and cost. Beijing must take Taiwan and dominate local

terrain, like the South China Sea, before it can devote resources on a sufficiently large scale to fulfill a wider range of extra-regional missions. While China can clearly project power and influence events across the Indian Ocean region and simultaneously develop a powerful deterrent force against Taiwan and other local flashpoints, as it has over the past decade, contingencies closer to home clearly impose a handicap on Beijing. China's strategy should thus be understood in sequential terms: Beijing must establish the basis for primacy in Asia before turning to grander ambitions on the world stage. And the path to preeminence runs through Taiwan.

The second hypothesis is that there will be continuing tension between China's immediate priorities over Taiwan and its longer-term ambitions in extra-regional theaters. Beijing's preoccupation with the island continues to tie down a sizable proportion of resources that it would otherwise prefer to use for other missions farther afield. If Taiwan stays out of China's hands, then the PLA would need to sustain investments in both its general-purpose force and its contingency-specific force in coming years. Whether this dual structure is sustainable and whether China can go global, despite the resources that Taiwan and other local disputes continue to consume, are critical uncertainties for the Chinese leadership. If the island falls to the mainland and third parties do not contest such a union, then, at a minimum, the uncertainties lift, giving the PLA the choice to shift decisively toward a global force posture.

If these two hypotheses are correct, then the close allies must exploit and exacerbate China's global-local dilemmas to the maximum extent possible. First, the fate of Taiwan will not only determine Asia's power balance, but it will also influence Chinese decisions and options as Beijing extends its influence beyond the Western Pacific. As such, the allies must not treat Taiwan as a liability. Taiwan is not an impediment to great power amity between China and the United States. Rather, the allies should view the island as a bulwark against Beijing's regional and global ambitions. Placing Taiwan in the context of a larger and longer-term rivalry with China is essential to understanding the nature of the cross-strait stalemate and the allied role in the standoff.

Second, the defense of Taiwan and the integrity of the U.S. and allied positions on the first island chain are inseparable. In fact, they are mutually reinforcing. Allied cooperation on Japanese and Filipino territories would strengthen cross-strait deterrence while making a Chinese campaign very costly should war break out. A strong Taiwan that can effectively resist Chinese coercion and aggression reinforces the favorable military balance that the United States and its allies on the first island chain have enjoyed for decades. Conversely, the fracturing of alliances on the island chain would make defense of Taiwan far more difficult while the loss of Taiwan would confer to China a commanding geopolitical position over Japan, the Philippines, and the South China Sea.

Third, the allies must force costlier choices on China. Measures to harden the front-line states, including Japan, Taiwan, and the Philippines, not only complicate the PLA's campaigns plans, but also compel Beijing to stay fixated on local contingencies at the

expense of its extra-regional ambitions. To be sure, China has been able to go global even as it has grown much stronger in Asia. But, the allies should nevertheless seek to sharpen the opportunity costs for China. Otherwise, Beijing would be afforded the strategic space to continue its ascent resistance free and this permissive environment would open for China more possibilities in Asia and beyond. Taking a stand now to convince China that it cannot rise unconstrained in Asia would decrease Beijing's confidence in its ability to fulfill its global objectives. Failure to act sooner would only postpone the day of reckoning while increasing the costs of resistance later.

Fourth, the scenarios show that the United States and its allies must devote substantial and sustained resources to defend the first island chain. Efforts to impose costs on the PLA, enhance resilience against China's first strike or first-mover advantage, maintain offensive options, apply collective pressure on China, and defend Taiwan effectively will require close coordination and steady progress on multiple fronts. Conversely, the scenarios show that a loss of momentum and benign neglect could inflict serious harm on allied cohesion and unity of effort. Worse still, wishful thinking by the frontline states could prove toxic as they fall back on the hope that the United States would ultimately intervene. It would simply invite China to shatter those illusions.

Fifth, at the campaign level, the task before the close allies is as daunting as it is multifaceted. Unlike a decade ago, a conflict over Taiwan likely will not be limited to the confines of the first island chain and will involve several sub-theaters simultaneously as soon as the first shots are fired. In addition to Chinese deep strikes against targets located as far as the second island chain, the PLA could launch long-range precision fires and air and naval sorties from the manmade Spratly bases toward the Sulu and Philippine Seas and the Bay of Bengal. Those manmade islands would also host a dense network of overlapping anti-access bubbles, creating a formidable bastion in the heart of the South China Sea. At the same time, several surface action groups and nuclear attack submarines could prowl the far seas as raiders to disrupt allied operations. It is worth noting that Western planners, with few exceptions, had not anticipated the multi-theater and multi-vector character of the PLA at the turn of the new century, demonstrating how far the Chinese have come.

Sixth, should deterrence fail, the allies must impose costs on China with their own anti-access capabilities in the near seas while seeking to wage and win a war at sea against Chinese blue-water forces across the Indian Ocean littorals. Fighting a two-theater campaign of this kind would require the allies to develop competencies that have atrophied since the end of the Cold War. They would have to hone skills in a contest for sea control in the open ocean. They would also need to rediscover tactics and doctrine for close-in sea denial operations, such as aerial and undersea offensive mine warfare. Long-accustomed to maritime supremacy and second-rate military powers that posed little threat to that dominance since the Soviet Union's collapse, the allies will have to undergo a shift in mentality as much as a change in posture within a far more competitive environment. It would be prudent to devise a division of labor among the allies. The frontline states should carry

heavier burdens along China's periphery while the United States and other allies and partners, including Australia and India, systematically target China's seagoing forces in the Indian Ocean.

As the allies prepare for this future, they need to be strategically opportunistic. China's defense burdens closer to home and the proliferation of global interests and associated constabulary missions suggest that Beijing may be vulnerable to imperial overstretch. The allies need to be alert to signs of overextension and devise strategies to exacerbate or manipulate such overreach. As made clear above, it is within the power of the close allies to force costlier choices on China. Keeping Beijing fixated on more immediate aims that, if unachieved, would preclude it from obtaining its long-term goals is one way to impose opportunity costs. Or, to frame this proposition in Xi's terms, it behooves the close allies to keep the China Dream—and the intermediate objectives necessary to reach that Dream—unfulfilled for as long as possible. The more time that the allies buy in this competitive process, the better chances they will have to bend the terms of the competition in their favor.

Finally, as the PLA's force composition alters over time, Beijing's risk calculus will change alongside the material metamorphosis. For example, the PLAN's modernization appears to be giving birth to a Chinese version of Imperial Germany's High Seas Fleet. This "lumpy capital" is a vulnerability ripe for exploitation. For the close allies, holding at risk the tools that China values most would furnish them the leverage to compete effectively in this long-term rivalry and, should deterrence fail, compel Beijing's will.

## APPENDIX F

# Primary Geo-economic and Geo-strategic Scenarios for 2035

Aaron Friedberg and Nadège Rolland

### Introduction

In generating scenarios for China's place in the international system this paper assumes that there will be two primary driving forces. The first will be the rate of growth of China's "comprehensive national power" and the manner in which the nation's leaders define its interests and objectives. The second driving force will be the capabilities of a nascent coalition of other nations and the extent to which they perceive the necessity, and have the ability, either to accommodate China or to work together to counter the potentially harmful effects of its rise.

We assume further that, other things equal, a nation experiencing rapid growth in its relative wealth and power will seek to alter, and may attempt to overthrow or fundamentally transform, the international system of which it is a part, including existing rules and institutions, patterns of trade and investment, territorial boundaries, and hierarchies of prestige that were created when it was relatively weak. A rising power will thus define its interests and goals in increasingly expansive ways, although the precise manner in which its leaders do so will be determined not only by their country's growing material strength, but by domestic factors, including the character of its domestic political institutions and the content of its prevailing ideology.

Similarly, we assume that there is a strong tendency towards balancing in international politics. Fearful that a rapidly rising power could threaten their interests, their autonomy,

and perhaps even their survival, the other states in an international system will generally take steps to defend themselves, whether by building up their own capabilities, cooperating more closely with other states, or through some combination of the two. How expeditiously and effectively they do these things will vary, however, depending again on an array of factors, including the ability of national leaders to forge a domestic consensus on the need to take costly measures and their skill in overcoming the inevitable political, bureaucratic, and diplomatic obstacles to achieving meaningful cooperation with other states. Balances of power do tend to form in international politics, but they do not form automatically and may not emerge quickly enough to deter or defeat initial acts of aggression by ambitious rising states.

### **Geo-Strategic Scenario 1: China Balanced**

In this first scenario a confluence of favorable developments enables a U.S.-led coalition to preserve what former National Security Adviser Condoleezza Rice once described as “a balance of power that favors freedom” in the Indo-Pacific region.<sup>120</sup> In sum, the balance of power balances, and it does so in a way that deters major aggression and stems Chinese expansionism, enabling most of the states that do not immediately border the PRC to preserve their autonomy. The United States maintains its alliances and forward military presence and defends freedom of access to and through the waters and airspace off China’s coasts.

Although China’s economy continues to expand, its growth is slowed considerably by a number of factors, including the cumulative effects of a protracted conflict over trade and investment with the United States and the other advanced industrial democracies. After first trying to pressure Beijing into abandoning its subsidies, market access restrictions, and coercive technology transfer policies, the U.S., Japan, and the EU impose stiff tariffs on Chinese exports and tighten restrictions on Chinese investment in key sectors of their economies. With their access to foreign markets and technology constricted, most elements of Beijing’s “Made in China 2025” program end up as costly failures, as do many of the infrastructure projects launched with great fanfare as part of the Belt and Road Initiative. A debt crisis ensues. Slower overall growth, coupled with the rising costs of caring for a rapidly aging population and maintaining control over an increasingly restive population, exert downward pressure on military budgets. Heightened barriers to buying (or stealing) foreign technology also make it more difficult for the PLA to continue to close the qualitative gap between its latest weapons systems and those deployed by the United States and its allies. Slower growth also makes it more difficult for Beijing to wield the instruments of “soft power.” China has less money with which to fund aggressive political influence campaigns or woo foreign governments with the promise of much-needed investments. Less tangible but

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120 Condoleezza Rice, “2002 Wriston Lecture: A Balance of Power that Favors Freedom,” October 1, 2002, available at: <https://www.manhattan-institute.org/html/2002-wriston-lecture-balance-power-favors-freedom-5566.html>

no less significant is the fact that the narrative of China's inevitable rise, and claims about the superiority of its authoritarian, state capitalist development model, have lost much of their credibility.

Notwithstanding these setbacks, the CCP regime continues to press towards its goal of achieving regional preponderance by the "second centenary" in 2049. Indeed, faced with a less welcoming external environment and mounting internal challenges, Beijing feels an even greater need to stir patriotic sentiments by adopting a tough stance in its dealings with its neighbors and other foreign powers, including the United States. The regime steps up economic, diplomatic, and military pressure on Taiwan, engages in increasingly provocative behavior towards Japan over the Senkakus, and declares an Air Defense Identification Zone over portions of the South China Sea. PLA ground force units engage in periodic incursions into territory claimed by India. PLAN submarines and surface vessels begin rotational deployments to Chinese-built ports in Pakistan and Sri Lanka and conduct regular, large-scale exercises across the Indian Ocean and into the Arabian Sea.

The net effect of all this activity is precisely opposite to the one intended by Beijing. Instead of being cowed into submission, countries across Asia become increasingly anxious about China's intentions and the implications for their own security. Allied and non-allied governments alike expand their defense cooperation with the United States and with one another. Among other developments, Vietnam and the Philippines make air and naval facilities available to U.S. forces, facilitating the United States' permanent presence in and around the South China Sea. Japan boosts defense spending to over 2 percent of GDP, sells patrol boats, anti-ship missiles, and diesel submarines to several of its neighbors, and begins strategic exchanges with Taiwan. The U.S.–Japan–Australia–India "quad" solidifies into an increasingly capable quasi-alliance mechanism, with regular high-level meetings, intelligence exchanges, and military exercises. India joins with Australia, Japan, the U.S., and other nations, including France, Great Britain, and Indonesia, in conducting frequent freedom of navigation operations through waters claimed by China.

Faced with effective counterpressure along its southern borders and maritime frontiers, Beijing turns inland and westward, seeking to consolidate and expand its relations with Russia, the Central Asian republics, and the mostly small, poor states along Russia's western perimeter. In what is, in effect, a new Cold War, Eurasia is divided into an authoritarian, continental coalition centered on China and a grouping made up primarily of maritime democracies, led by the United States. The global economy too becomes increasingly segmented. Free trade agreements link the EU, the U.S., Japan, South Korea, Australia, and others into a unit made up almost entirely of democratic countries that together comprise over 60 percent of world GDP, while China seeks to expand its economic relations with emerging economies, especially those along the Belt and Road. BRI projects extend south and west, enabling China to satisfy a significant fraction of its energy needs through over-land pipelines.

## Geo-Strategic Scenario 2: Regional Preponderance

Suppose that the Communist Party continues to rule and that, like their predecessors, the nation's leaders remain committed to the goal of reestablishing China as the preponderant power in eastern Eurasia. Suppose further that, Beijing is able to ameliorate its differences over issues of market access and technology transfer with the United States and the other advanced industrial democracies in ways that enable it to sustain growth rates healthier than those assumed in the previous scenario. Suppose finally that, thanks to a mix of continued enhancements in living standards and dramatic improvements in surveillance technology, the regime becomes more secure and self-confident in its ability to suppress unrest and maintain tight political control. Feeling less need to stir patriotic passions through manufactured crises and confrontations, the leadership is able to modulate its foreign policies more precisely, avoiding many of the more aggressive and self-defeating actions to which it might otherwise be prone. Assuming that the United States and its strategic partners continue to act in ways intended to maintain a balance of power, these changes in Chinese behavior will probably not be sufficient, in themselves, to enable Beijing to achieve its goal of regional preponderance.

But now consider a world in which U.S. policy begins to deviate significantly from the path it has followed for the past quarter century and, indeed, for most of the period since the end of the Second World War:

Washington refuses to participate in multilateral trade agreements and eventually withdraws from the World Trade Organization. The U.S. imposes tariffs on imports from a number of countries, including many of its allies in both Europe and Asia, and demands that they renegotiate existing trade deals and commit to importing more U.S.-made products.

At the same time as it picks fights over trade, the United States presses its allies harder to increase their military budgets and to take on a greater portion of the responsibility for their own defense. Although it does not immediately terminate its alliances or withdraw all of its forward-based forces, in the interest of cost saving Washington makes significant reductions in overseas bases, forces, and multinational training exercises.

As more American politicians and “thought leaders” begin to break with past orthodoxy and question the value of alliances and overseas commitments, public attitudes start to shift. Having been sustained since the end of the Cold War by a virtually unbroken expert consensus, and by a mix of inertia and general indifference, popular support for the status quo begins to unravel. Public opinion polls show a decline in the numbers of people who express enthusiasm for existing alliances in the abstract, or who answer in the affirmative when asked if the U.S. should come to the aid of specific countries if they are attacked. The downward spiral is mutually reinforcing: evidence of eroding public support encourages more aspiring political leaders to speak out against international engagement, which hastens the shift in mass opinion. Left and right wing variants of isolationism emerge in the two main political parties.



Chinese strategists skillfully encourage and exploit growing doubts about America's resolve and staying power, as well as mounting anger over its unilateralist trade policies and aggressive demands for a rebalancing of defense burdens. Beijing pursues a two-pronged policy towards its neighbors. First, it continues to build up its conventional and nuclear capabilities, periodically displaying and in certain respects exaggerating its own strength to encourage doubts over the long-term viability of U.S. security guarantees. Accompanying this hard line is a much softer approach that emphasizes the use of soothing diplomacy, influence operations and economic inducements.

Beijing reaches out to the EU, negotiating deals that give European firms enhanced access to the Chinese market at the expense of their American competitors. This helps to widen the trans-Atlantic divide while forestalling the formation of a unified coalition of advanced industrial nations that might have been able to confront China successfully on trade issues. In Asia, Beijing pushes for a new free trade area that would incorporate virtually all of the major regional players while excluding the United States. Both in the maritime domain and across continental Eurasia, Beijing forges ahead with investments in roads, rails, pipelines, ports, and fiber optic cables, creating a vast but increasingly integrated regional economy, one with China at the center and its neighbors drawn increasingly into its orbit. In contrast to their American counterparts, whom they portray as narrow-minded, selfish, and backward-looking, China's leaders cast themselves as dynamic and visionary, with bold solutions to the world's problems and the money to back up their promises.

Beijing is finally willing to use its leverage over Pyongyang and its position as an interlocutor to broker a resolution to the North Korean nuclear issue and a peace agreement between North and South Korea. This marginalizes the United States and results in the eventual removal of American troops from the peninsula and the termination of the U.S.-ROK alliance. Confronted by a situation that appears hopeless, and increasingly dangerous, Taiwanese political leaders conclude that they have no choice but to accept a version of a "one country-two systems" deal with Beijing. Facing diplomatic isolation in the region, uncertain of American support over the long-term, and with an aging population that remains averse to "militarism" and nuclear weapons, Japan's leaders also decide that they must reach an accommodation with China and downgrade their alliance with the United States.

The end result of these developments is a regional economic and political system in which China's power is no longer balanced by the combined capabilities of a countervailing coalition. Even if it has not physically conquered its neighbors, Beijing has successfully divided them, both from one another and from the United States, enabling it to emerge as the preponderant power in eastern Eurasia. The United States is pushed back across the Pacific. Guam and Hawaii are now the western-most outposts of American power.

### Geo-Strategic Scenario 3: Global Hegemony

As was true for the United States at the turn of the twentieth century, so also for China, a secure regional base may provide a platform for the outward projection of power and influence on a truly worldwide scale. Although China's potential emergence as a global player on par with, and perhaps eventually superior to, the United States will likely exceed the 15 year time horizon of this paper, Chinese strategists and policymakers are already beginning to think in these terms.

In certain respects this third scenario emerges from a further extrapolation of the trends driving the previous one: the continuing expansion of Chinese power and a feeble, divided, and ineffective response from other states. Fueled by fresh waves of innovation, over the next two decades China is able to dominate most of the technologies underpinning the "fourth industrial revolution." Notwithstanding rising labor costs and an aging population, its economy continues to grow at a healthy pace. The economies of the advanced industrial democracies struggle to keep pace as they are wracked by divisive battles over identity politics and income redistribution, weighed down by debt, regulation, and inadequate investments in education and basic research, and weakened by the cumulative effects of Chinese predation.

By 2040 economist Robert Fogel's 2010 prediction has been proven correct: China now accounts for 40 percent of global GDP, versus 14 percent for the United States and only 5 percent for the EU. In addition to being merely big, China's economy is now the world's most advanced and its people are among the wealthiest, with per capita incomes double those of many European countries.<sup>121</sup> Chinese universities and research institutes are the world's best, able to attract top talent from around the world. Chinese firms dominate the top rungs of the value-added chain and set technical standards, and other countries are dependent on them for the most advanced components, sub-systems, and software. Telecom giant ZTE's dependence on foreign semiconductors, and its humiliating near-collapse in the face of threatened U.S. export restrictions are a distant memory. Indeed, the shoe is now on the other foot: China regulates exports of high-tech products and restricts foreign direct investment in its economy to preserve an advantage over potential commercial competitors.

Beijing sits at the center of a vast physically and virtually integrated pan-Eurasian economic zone whose terrestrial boundaries extend from maritime northeast Asia to the heart of Western Europe, and from the Arctic Ocean to the Mediterranean and the Persian Gulf. Within this zone the RMB is the primary medium of exchange and Chinese companies own and control (or have ready access to) most of the telecommunications infrastructure.<sup>122</sup> China is effectively invulnerable to economic or financial sanctions and its exposure

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121 Robert Fogel, "\$123,000,000,000,000," *Foreign Policy*, January 4, 2010, available at: <https://foreignpolicy.com/2010/01/04/123000000000000/>

122 For a speculative account of what such a system might look like see Nadège Rolland, *China's Eurasian Century* (Seattle: National Bureau of Asian Research, 2017), pp. 121-149.

to possible disruptions in supplies of energy, food, or raw materials has been greatly diminished by construction of overland transportation links, as well as the development of a blue water navy, a massive merchant fleet, and an extended network of ports and other logistical facilities. China's economy supports the world's largest, most technologically advanced, and most capable military establishment. Chinese naval vessels patrol the sea lanes. The PLA can project power virtually anywhere in the world at relatively short notice.

The CCP regime uses its growing clout to reshape existing international institutions and norms, weakening those that pose a threat, and building new ones that better advance its interests and reflect its governing ideology. Beijing uses bribery and pressure tactics to gain control of international bodies like the UN Commission on Human Rights, subverting, neutralizing, and eventually disbanding them. The Universal Declaration of Human Rights, one of the founding documents of the UN system, is rewritten to remove references to freedom of thought, expression, and assembly. Beijing brings intense diplomatic and economic pressure to bear on countries that refuse to extradite those it accuses of crimes against the Chinese state or that permit NGOs critical of its domestic practices to operate on their territory. The corporate owners of news organizations that carry stories detailing repression of minorities or high-level corruption face a loss of access to the Chinese market or hostile takeovers by well-funded and more pliant buyers.

China establishes an array of banks and international development institutions, and new Beijing-based tribunals for resolving disputes with its major trading partners. Although they initially distinguish themselves from their Western counterparts by not requiring improvements in transparency or other reforms, these new institutions increasingly impose conditions of their own, including requiring that recipient governments protect the interests of Chinese firms and suppress protests or unfavorable media attention directed at Chinese-funded projects. Having abandoned its previous reticence about appearing to engage in ideological competition with the West, Beijing more actively promotes its own model of market-driven authoritarianism, including through expanded economic assistance, security cooperation, and lucrative scholarship offers to foreign elites seeking education and training. China organizes its own counterpart to the G-7, a larger grouping of countries spread across Asia, the Middle East, Latin America, and parts of Europe that align themselves with China's policies and its vision of "responsible governance." As was true during the decades of American preponderance that followed the end of the Second World War, China's material success is mirrored in global trends in commerce, culture, entertainment and language.

The United States and the other liberal democracies find themselves increasingly isolated. They account for a dwindling fraction of the world's population and wealth and cling to bastions in North America and parts of Europe and Australasia. With ties to its traditional partners attenuated, the United States appears to be in danger of fulfilling Henry Kissinger's

prophecy that, without allies, it “would become, geopolitically, an island off the shores of Eurasia.”<sup>123</sup>

## Geo-Strategic Scenario 4: Liberal China

Each of the scenarios discussed thus far proceeds from the assumption that the Chinese Communist Party remains in power and that it continues to pursue the same objectives that have guided it for the last several decades. But continuity is not inevitable and change, even revolutionary change, is always possible. Suppose that China does, in fact, make a transition to liberal democracy, how might that influence the trajectory of Chinese power, the attitudes of its leaders and their country’s position within the global political and economic systems?

As noted in Chapter 4, there are a number of reasons for doubting that a transition to democracy will be smooth, or that it will take place as the result of a controlled, top-down process of reform. A fundamental shift in the character of China’s domestic political system will most likely involve a measure of internal conflict and societal disruption and it will probably take some time, perhaps several years, to unfold. The historical record also suggests that regimes in transition from authoritarianism to democracy are especially prone to aggression.<sup>124</sup> If similar patterns prevail, then the period following the CCP’s removal from power could be marked by tension and possibly even conflict between China and some of its neighbors.

Assuming that it can be managed without a major breakdown in relations with other powers, China’s transition to democracy will likely have four interlocking effects. First, notwithstanding temporary dislocations that accompany the unwinding of CCP power and the dissolution of the state planning system, the eventual rollback of wasteful subsidies, downsizing of state-owned enterprises, and expanding the role for a dynamic private sector will clear the way for sustained, stable economic growth. A China that liberalizes economically as well as politically will be an even more capable and innovative commercial competitor on global markets and, in the long run, its national wealth and power will grow even more rapidly than would otherwise have been the case.

As it becomes richer and stronger, the goals that a liberal China seeks will change and, to an even greater extent, so will the manner in which it pursues them. The politics of a newly democratic China will still be suffused with nationalism; its leaders and its people will still want their “place in the sun.” In contrast to their CCP predecessors, however, the duly elected representatives of the Chinese people will not have the same need for external enemies and constant crises to justify their rule. They will not feel themselves to be in

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123 Henry A. Kissinger, *Does America Need a Foreign Policy? Toward a Diplomacy for the 21st Century* (New York: Simon and Schuster, 2001), p. 52.

124 See the discussion in Aaron L. Friedberg and Nadège Rolland, “Primary Scenarios for China’s Political Leadership and Political System in 2030,” July 2018.

constant danger of humiliation at the hands of foreign powers or subversion by domestic opponents, nor will they feel their legitimacy and perhaps their very existence threatened by the principles of openness, reciprocity, rule of law, and universal human rights embedded in the norms and institutions of the contemporary, Western-built international system. A rising, liberal China will want prestige, deference, acknowledgement of its interests and a greater say in the events of its region, and the wider world. But, having made the transition to democracy, it is more likely to seek those things within the confines of the existing order than it is to try to transform the system in fundamental ways, still less to overthrow it.

At least in its dealings with other similar states, a liberal China will also be far less prone to use force to achieve its objectives. Like others that have undergone liberalizing reforms, a transformed China will probably enter into the democratic “zone of peace.” Its leaders and its people will regard their fellow democracies as legitimate and deserving of respect, and will seek to resolve whatever differences they may have peacefully, through negotiation and compromise, rather than through threats and violence.<sup>125</sup> On the other side of the table, China’s democratic interlocutors will be more inclined to trust its promises, and less fearful of its intentions.

Thanks to the combination of its growing power, more moderate aims, and less aggressive behavior, a democratic China will encounter less resistance and will find it easier to achieve its objectives. The Taiwan issue will be resolved peacefully, and Beijing will reach agreements on joint exploitation of maritime resources with Japan and the Philippines, deferring questions about sovereignty or submitting them to arbitration before international tribunals.

Perhaps most important, China’s transformation will clear the way for a deep and lasting *modus vivendi* with the United States. While differences and occasional frictions will persist, American policy makers will no longer see their strategic interests as being threatened by China’s rise, nor will they perceive it as posing an ideological challenge to the principles of liberal democracy. Just as London gave way before the United States at the turn of the twentieth century, permitting it to dominate the Western Hemisphere, Washington too will stand aside and allow China to become the preponderant power in East Asia. And, as for America so also for China, regional hegemony will be a stepping stone on the way to global preeminence.

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125 Regarding the existence of, and possible explanations for, the “zone of peace” see Michael W. Doyle, “Kant, Liberal Legacies, and Foreign Affairs.” *Philosophy and Public Affairs*, Volume 12, No. 3, Summer, 1983, pp. 205–235 and “Kant, Liberal Legacies, and Foreign Affairs, Part 2,” *Philosophy and Public Affairs* Volume 12, No. 4, Autumn, 1983, pp. 323–353

## LIST OF ACRONYMS

<b>BRI</b>	Belt and Road Initiative
<b>CCP</b>	Chinese Communist Party
<b>CPSU</b>	Communist Party of the Soviet Union
<b>DPRK</b>	Democratic People's Republic of Korea
<b>EU</b>	European Union
<b>GDP</b>	Gross Domestic Product
<b>ICT</b>	Information and Communications Technology
<b>IMF</b>	International Monetary Fund
<b>KMT</b>	Kuomintang
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>PLA</b>	People's Liberation Army
<b>PLAAF</b>	People's Liberation Army Air Force
<b>PLAN</b>	People's Liberation Army Navy
<b>PPP</b>	Purchasing Power Parity
<b>PRC</b>	People's Republic of China
<b>RMB</b>	Renminbi
<b>ROC</b>	Republic of China
<b>ROK</b>	Republic of Korea
<b>SOE</b>	State-Owned Enterprise
<b>TFP</b>	Total Factor Productivity
<b>UN</b>	United Nations
<b>US</b>	United States
<b>USSR</b>	Union of Soviet Socialist Republics
<b>WTO</b>	World Trade Organization





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