

# **China on the Threshold of a Market Economy**

Tony Saich

Daewoo Professor of International Affairs

Kennedy School of Government

Harvard University

March 2001: Not to be Quoted Without Author's Permission

As China enters the new century, it is clear that its economic reforms have made enormous progress but the country is still far from being as strong and wealthy as its leaders desire. The growth of its economy, its pending entry into the WTO, and its permanent seat on the UN Security Council mean that it is taken increasingly seriously in world affairs. However, there are considerable challenges ahead with the economic transformation and China has not clearly identified its role in the international community. Certainly in comparison with the former Soviet Union, China's progress has been impressive and its leaders have argued that its gradualist approach is preferable to the "shock therapy" policies that have caused a precipitous collapse in economic activity and living standards for many in Russia. China's leaders argue that authoritarian rule with an essentially market economy operating under centralized political control that tolerates no organized opposition to flourish is most effective for development. Instead of invoking Marxism, China's new generation of leaders use arguments about economic development to justify their authoritarianism. They have drawn the conclusion from the swiftly developing economies of East and Southeast Asia that the modernization process requires a strong centralized political structure, especially in the early phases, to prevent social divisions from undermining it. They hope that this will help them push through unpopular measures without mass protest. Quite simply, they equate democratization with chaos and chaos with underdevelopment. This chapter looks at China's progress to date with this model for transition and examines the future challenges and how they may impact on the land and the external world more broadly.

## *The Contours of Reform*

There can be no doubt that in economic terms the reforms launched by Deng Xiaoping and his allies have achieved considerable success. Since 1978 GDP growth rates have average 10 percent per annum, 10.7 per cent in the 1990s; by contrast that for Russia declined by 6.1 percent per annum in the 1990s. Average per capita income has increased from around \$150 in 1979 to around \$900 at present with major cities such as Beijing and Shanghai approaching \$4,000 per annum. China has attracted a massive \$3 billion in foreign direct investment since 1980 and has around \$160 billion in foreign reserves. However, these aggregate figures hide a number of potentially worrying trends and new problems that we shall return to below.

Coming out of the economic disasters of the Great Leap Forward (1958-60) and the political and economic dislocation of the Cultural Revolution (1966-76), in December 1978, the Central Committee of the Chinese Communist Party (CCP) decided that the focus of future work would be economic modernization and that all other work must be subordinated to meeting this objective. The CCP's legitimacy was shifting effectively to the capacity of the leadership to deliver the economic goods. This approach resulted in significant changes in the relationship between the plan and the market and the party and the economic decision-making apparatus, with previous regime practice significantly liberalized.

The reforms in China share certain features with those in other former state-socialist systems. There has been a progressive decline in the state control of the economy, with powers devolved from state agencies to enterprises, and a decrease in the use of

mandatory planning mechanisms and a concomitant increase in the use of market forces to guide distribution and increasingly production choices. The role of the market has been gradually extended beyond goods and services to labor, now increasingly seen as a commodity. Awareness of the 'new technological revolution' increased the Chinese leaders' desire to make their system more flexible and thus more amenable to change. To take advantage of market opportunities, more power of decision-making was to be given to the localities, and in particular to the units of production themselves. Production units now have more autonomy to decide what to produce, how much and where to market the products. At the core of this system lie the ubiquitous contracts that are expected to govern economic activity. Corresponding material incentives are seen as the major mechanism to stimulate people to work harder, and the socialist principle of 'to each according to his work' is to be firmly applied. Egalitarianism is attacked as a dangerous notion that retards economic growth. This is best reflected in Deng Xiaoping's much-quoted dictum 'to get rich is glorious'. These reforms of the domestic economy have been accompanied by an unprecedented opening to the outside world in search for export markets and the necessary foreign investments, technology and higher quality consumer goods. By contrast, there has been resistance to allowing the development of a market place in political ideas.

The economic changes have redefined the social structure and are changing the distribution of power between state and society, have altered the principles on which society is organized and the ways in which it interacts with the state apparatus. Chinese society has become more complex as a result in terms of both structure and attitudes and at the same time has become more fluid and dynamic than at any time since the early

1950s. There is greater social and geographical mobility and horizontal integration and integration has developed as the vertical and cellular boundaries of the traditional Leninist system have become more porous. Finally, there has been a significant redistribution of economic power away from the state and its ancillary agencies and towards groups, new or reformed institutions, households and perhaps even individuals.

Importantly, in terms of initial success, the reforms did not have a blueprint and often the Center appeared to be responding to policy innovation at the local levels. This allowed a flexibility for policy implementation that allowed different provinces to exploit their comparative advantages. In particular, the coastal provinces were able to take advantage of the new trade and investment policies to experience a period of rapid growth. This reversed the old Maoist policies that had favored the Northeast and Sichuan that were the sites of the heavy industrial sector. Despite this reversal and the growing disparity between the urban and the rural and the coast and the hinterland, on the whole in the 1980s the reforms were remarkable for creating no significant losers. This was important for widening and consolidating the support base for further reform.

However, by the mid-1990s it was clear that this strategy was running out of steam and it was becoming apparent that there would be casualties as well as beneficiaries of reform. In 1993-94, the central leadership decided that a more coherent set of central policies was necessary to prevent the economy from overheating, and to prevent runaway inflation and local initiative and growth from escaping from central macroeconomic control. In particular the state was having difficulty in securing its revenue base.

As a result, for the first time the Center drew up a comprehensive statement of its reform plans and articulated them again in 1997-98. By 1994 the reform agenda of the 1980s was basically completed and now the leadership had to deal with the tough parts of reform, such as the State owned enterprise (SOE) system, the institutional impediments to rural-urban labor flows, the banking system, and the integration of domestic markets with foreign competition.

The Center clearly felt that the days of piecemeal reform were numbered and that China had to make a dramatic break with the past to ensure continued economic growth by getting at the structural problems and to prepare for China's entry into the WTO. The program if fully implemented would reduce further the intrusive role of the state in both economy and society and contribute to far greater social differentiation. While none of the reforms are new, it was the comprehensive way in which they have been packaged and the zeal with which they were presented that was surprising. In their totality, the policies would amount to a 'revolution' in the relationship between state and society in terms of taking the former out of crucial areas of the life of the latter. With individuals increasingly responsible for finding their own work and housing, taking more individual responsibility for social security and pensions, and becoming consumers in an increasingly marketized economy, it is inevitable that they will wish to have a greater political voice and accountability over officialdom.

The report of General Secretary Jiang Zemin to the 15<sup>th</sup> Party Congress (1997) marked the clearest commitment to a mixed economy with theoretical continued dominance of the state sector. In reality, and in local response, the policy amounts to privatization in all but name. To preempt criticism, Jiang stated that even a smaller role for the state-owned sector of the economy would not mean that the 'socialist nature' of the country had changed. While

appropriating the collective sector of the economy as a form of public ownership, Jiang referred to the remainder (non-public sector) of the economy as comprising an important component that should have its 'legitimate rights and interests' protected by law. This was picked up at the 1998 NPC meeting and the State Constitution to be amended to reflect the parity of the non-state sector of the economy. This parity of assessment, regulation and constitutional change is vital to enable the non-state sector not only to avoid attacks from the opponents to further radical reform but also to gain access to loans from state-controlled banks. Industrial entrepreneurs and reform-minded local officials complain about the banks' preference to provide loans to state-owned enterprises. This preference not only derives from the close links between local officials and entrepreneurs in many regions but also the lack of expertise that bank staff have in assessing risks of loans to the private sector. In fact, in 1998 the private sector accounted for only one per cent of the loans from state banks.

With the onset of the Asian financial crisis and the realization that China's banking system is as perilously placed as many of those that collapsed in the surrounding countries, reformers were able to push ahead with a comprehensive package of new policies that culminated in Premier Zhu Rongji's presentation at the National People's Congress in March 1998. He announced an integrated set of five major reform measures. First, approving plans proposed a decade before, Zhu announced that China would set up a nationwide grain market to ease the country's reserves. Most importantly, China would reduce the massive amount of government subsidies pumped into the system because of the remaining influences of the Maoist obsession with self-sufficiency in grain. Second, the investment and financing system was to be overhauled to prevent wasteful duplication of capital investment, with the People's (Central) Bank stepping up its regulatory functions and commercial banks being allowed to

operate independently. The local branches of the People's Bank along regional lines to reduce political interference by powerful provincial party chiefs in lending decisions. As Zhu noted the 'power of provincial governors and mayors to command local bank presidents is abolished as of 1998'. Third, the old system of the work-place providing housing was to be abolished through a major program of sales to occupiers. For those who chose not purchase housing, rents were projected to rise to around 15 percent of the family income. Fourth, Zhu revealed that a new nationwide medical care reform program would be introduced in the second half of 1998 to replace the existing work-based system. These two measures were a part of the program to relieve the financial pressures of the SOEs that had traditionally provided cradle-to-grave welfare services. Finally, the tax collection system was to be rationalized to prevent the levying of excessive fees and levies by local authorities that had been the source of much resentment and social unrest. While both Jiang and Zhu resisted mention of political reform, Zhu announced a massive restructuring of the government bureaucracy, with half the officials to be laid off and reassigned to new jobs.

The key question was the extent to which these reforms would be introduced and how implementation would be modified by interest groups at the Center and in the localities. Previous experience suggested that many of the more radical intentions would be blunted and this has indeed been the case. The difficulty of moving ahead on any significant reform shows that the central state is now far from autonomous. Senior leaders lobby on behalf of their ministries to avoid the worst administrative cut-backs, line agencies interpret policy to the benefit of their own sectoral interests, and localities seek to pursue their own economic agendas. The following two sections look at the challenges to implementation of these reforms and their consequences for China's future development.

## *The Economic Challenges*

Despite the impressive progress and growth mentioned above, the Chinese economy faces a number of serious challenges as it prepares for transition in a world of WTO and more open markets. First, growth has declined over the last few years and has not revived significantly despite massive state investment in major infrastructure projects. Given the demographics of China's population with some 12 million entering the workforce each year, the lay-offs in the industrial sector, and the massive underemployment in the agricultural sector, continued high growth will be essential. Second, the state-owned sector of the economy has deteriorated badly and most of the growth has been in new sectors of the economy, such as the collective, foreign invested and the private sector. These latter sectors have kept China afloat while the SOEs have become an increasing burden on state coffers. Third, this has put an enormous strain on the financial sector and many wonder whether it can cope with the accumulated losses. Such worries have been heightened by the Asian Financial Crisis and what it revealed about fiscal vulnerability in the 'Asian Miracle'. Fourth, in the rural sector there have been concerns about the decline in farmers' incomes, the slow-down in growth of the township and village enterprises that at their height had absorbed some 124 million workers, and whether China can continue to feed its growing population. Last, but not least, China's impending entry into the WTO will have a massive impact on all aspects of the Chinese economy and many analysts are uncertain how well it will manage the transition. In particular, WTO entry will cause further redundancies in the state sector, reduce fiscal revenues, and dramatically shift the CCP's traditional preference for self-sufficiency in basic food supply. At the same time, WTO entry offers the potential for growth in new sectors of the economy, particularly in the high-tech and service industries, and over the long-term

should be generally beneficial. The question remains as to whether China can weather the initial storm. This section will deal with the challenge of dealing with SOE reform and the related financial sector and with the agricultural sector.

Reforming the industrial sector has been the most difficult challenge for the central leadership as it goes to the core of the economic system that was set up under the central plan. Reform undercuts the interests of powerful bureaucracies that were set up to run the system and the working-class that the CCP was to represent the most advanced elements of. Not surprisingly reform attempts have been stop-go but by the latter part of the 1990s it was clear that the difficult reform could be delayed no longer. The problem of SOE reform provides a good example of the advantages and disadvantages of delayed reform and the way problems are nested and interrelated. Gradualism allowed the non-state sector of the economy to develop alongside that of the SOEs providing alternative employment opportunities for new entrants and for laid-off industrial workers. In addition, the private sector and the collective and joint venture sector of the economy provide over 60 percent of total value added in China's economy. In the absence of an effective government unemployment scheme, keeping superfluous workers in the SOEs provided an alternative to turning them out onto the streets where they may have formed a reservoir of the politically discontented. This is no longer financially viable. Economic pressures have made it impossible for the Center to remain on the fence while the localities were pursuing de facto privatization. The state simply did not have the money to keep bailing the sector out.

Delay in fundamental reform has also derived from the lengthy learning process that the leadership has undergone in grappling with this sector. It took a long time for central leaders to realize that simply stressing technological up-grading, improved management, limited

autonomy, and expanded market forces did little to improve the health of SOEs unless the external environment was significantly reformed and a proper sequencing of reforms introduced. Indeed, tinkering with these aspects could actually make the situation worse. China lacks the key institutional mechanisms needed to make corporate governance and by extension property rights function for producers in complex market settings. The problem is compounded by the fact that many SOEs have become net destroyers of assets, with what they consume being of far greater value than what they produce. The dilemma for the government is that they still provide significant revenue for all levels of government: in 1995 this amounted to 71 per cent of total revenue.

Some figures display the seriousness of the problem faced in the mid-1990s. Of the 100 000 plus industrial SOEs, World Bank figures suggest that perhaps less than 10 percent were fundamentally viable. SOEs absorbed 60 percent of national investment; received total subsidies amounting to one-third of the national budget; and net credit to SOEs reached over 12 percent of GDP in 1995. Importantly, 50 to 75 percent of household savings, mediated and directed by state banks, went to finance SOE operations. The World Bank estimated that in 1996 50 percent of SOEs lost money (unofficial estimates are higher). Showing the range of their activities, SOEs employ fully one-third of China's medical staff and some 600 000 teachers and administrators.

It must have become apparent that over the long-term government resources would be insufficient to pay depositors and bond-holders if SOEs were unable to service bad debts. At the same time, the state with a declining revenue base was unable to offer the same kind of bail-out. Subsidies declined from 6 percent of GDP to 4 percent in 1994. This made it virtually impossible for many SOEs to meet their full range of social obligations, and even

salary payments, thus in turn speeding up the need for pension, medical, and housing reform. The cost of social insurance and welfare funds as a proportion of the total wage bill rose from 13.7 per cent to 34 per cent in 1995. It is not surprising then that bankruptcies in 1996 rose by 260 per cent on the year before and that lay-offs are rising despite official concern about the pace. The total of 6232 bankruptcies exceeded the total for the previous seven years combined.

Such statistics have led the party leadership to decide, in a risky venture, to cut themselves loose from the working-class that they created in the 1950s and to reduce working-class expectations about what the state can provide. Rhetoric is still paid to the importance of the leadership of the working-class and policy is to give priority to finding work for laid-off workers. The reality, however, is that for many they are on their own to find new work in an economy that is increasingly unfamiliar to them and that requires very different skills than those they learned under the Soviet-inspired system.

A number reform initiatives have been pursued including: encouraging SOEs to pull out of certain sectors of the economy, clarifying ownership rights, separating the enterprise from government administration, and forming large enterprise groups that would be able to compete on the international market while allowing smaller SOEs to diversify ownership. From the mid-1990s two important reforms were introduced to attempt to reform this sector. The first was the establishment of a social welfare system independent of the individual enterprises and regulated through the government. The second was to harden the budget constraints by gaining control over bank loans, trying to introduce better discipline over lending, and commercializing loans.

Is the policy of reviving the SOEs working? On paper yes but emphatically no in reality. By the end of 1999 and throughout 2000, officials were beginning to highlight figures that showed the situation for loss-making SOEs beginning to turn around. In August 1999, the official *People's Daily* claimed that in the first half of 1999 profits had risen by 280 percent, with a major improvement in the Northeast. Here the number of loss-making enterprises was said to have fallen by 29.1 percent, while that of profitable enterprises had risen by 14.6 percent. In March 2001, the head of China's State Development and planning Commission declared that the 6,599 loss-making SOEs that made losses in 1997 had been cut by over 70 percent. This turnaround is not surprising. First, many of the really hopeless cases have been taken off the state books through mergers and acquisitions with more profitable companies. Second, Asset Management Companies have bought up the debt for many of the larger enterprises and thus it has been moved off the books of the SOEs. Most importantly, the SOE is no longer paying a large amount of interest on its bad loans. In this way many bankrupt SOEs have turned around from basket cases to seemingly profitable enterprises overnight. Whether the problem of SOE inefficiency is really resolved or not is an entirely different matter and many of the SOEs have avoided the necessary structural reforms to enable them to compete in the future post-WTO entry market.

As noted, the current phase of reform has highlighted the extreme weakness of the financial system. With the main role of state banks being to feed the SOE sector, they built up a huge portfolio of non-performing loans, the true extent of which no one really appears to know. Some have estimated it to be as large as 25 per cent of GDP and that the true net-equity value of the large state commercial banks (before the transfer of the non-performing loans to asset management committees) is almost certainly negative. It may require not only

internal restructuring but also at least \$200 billion in fresh capital to revive the state banks. Despite this and number of attempts at reforming the sector, Central leaders remain ambivalent about commercializing the banking system and see state banks as a mechanism to fund the state's severe fiscal shortfalls.

However, the leadership cannot prevaricate for long. The urgency of resolving the SOE and banking problem is heightened by the agreement signed on WTO entry between China and the US and the European Union. The consequences for what China has signed on to are enormous. By 2005, there will be no restrictions on foreign banking activity in China and prudential not national criteria should apply. Already by 2002 foreign banks will be able to conduct local currency work with corporate customers. Unless the Asset Management Committees (AMCs) and China's banks are able to clear up the debts within five years the challenges could be enormous and create a banking crisis in China. Even with the AMCs taking over much of the current bad loans, but only the pre-1996 non-performing policy loans, the banks will have to improve dramatically their future lending habits. The consequences for the macroeconomic situation will be far-reaching. To prepare its banks for the international competition, China will have to accelerate the liberalization of domestic interest rates, seek fuller integration between domestic and international capital markets and accelerate towards full convertibility of the currency.

While most attention has focused on the industrial sector, the most severe challenges for China lie in the rural sector. The economic reforms began and were initially the most radical in the agricultural sector. The abandonment of the commune system and collective farming with the return to a system based on household production throws up the question of whether there was still a socialist agricultural system in China. However, the success of the

early 1980s had soured by the end of the decade and become a policy headache for much of the 1990s. Initial reforms were pro-agriculture with increases in state procurement prices leading to a huge boost in farmers' incomes that pulled over 100 million people above the poverty line. Incentives were returned to the household and marketing opportunities for farm products rapidly expanded. By 1985, the leadership turned its attention to the urban areas and began restoring its traditional pro-urban policy bias while adopting new policies to promote export-led development that favored the coastal cities over the rural areas. The impact is clear to see. Growth in rural incomes slowed from 17.6 percent per annum from 1978 to 1984 to only 5.5 percent by 1987. The income gap between rural and urban areas that had been coming down began to widen and by 1986 it was 2.33:1, worse than it had been at the beginning of the reforms. The declining profitability of agriculture has led many to find off-farm employment or to migrate to the cities to look for work. The rapid expansion of small industry run by local township and village governments was able to soak up many and there is estimated to be between 80 to 120 million migrants in China. However, as noted above these rural enterprises are undergoing a significant restructuring and will be forced to restructure further after WTO entry and thus will not be able to provide such future employment opportunities. In urban China, the shake out at the SOES and the cut-back in urban construction as a result of the financial tightening will also reduce employment opportunities. This means that other options will have to be sought to resolve the rural problems including finding employment for the over 200 million agricultural workers who are estimated to be superfluous.

The major policy problems derive from the leadership's concerns of grain self-sufficiency and the decisions not to complete the program of marketization for the countryside. The

controlled prices for grain and the levels of quotas demanded have kept farmers' incomes low and prevented many from diverting their activities to more profitable agricultural pursuits. In addition, the lack of secure property rights has meant that the transfer of land to more profitable farmers has been difficult to bring about, making agriculture still a small-scale activity, farming on small parcels of often uneconomical land. Further, the lack of land as collateral has meant that access to credit is a major problem for most farmers in China.

Entry into WTO will have a major impact on the agricultural sector in China and this might impact considerably on future attempts to liberalize grain trade. In addition, the state cannot afford the subsidies that this system is costing them. In 1996 alone, the official amount of subsidies for grain, oil and cotton amounted to around \$4 billion, up 35 percent on 1995. WTO regulations will cause a traditional shift from traditional autarky to a policy based on international comparative advantage. Domestic subsidies as well as those on exports for agricultural products will have to be eliminated.

The Chinese leadership has begun preparations. The Chinese leadership has finally approved plans proposed a decade before to set up a nationwide grain market to ease the country's reserves and, most importantly, to reduce the massive amount of government subsidies pumped into the system. They have accepted that grain imports is feasible and have suggested that by 2010 China should be importing 5 per cent of its grain needs and that this should rise to 10 per cent by 2030. China has even stated that it would try to reduce production of some basic rural products in the expectation that market demand would be determinant. This signaled a major break with the traditional drive to increase output irrespective of market demand. Even grain production is to conform more to consumer pull rather than the push of planning diktat. Estimates showed grain production declining from

508 million tons in 1999 to a projected 490 million in 2000. The financial burden of four bumper harvests in a row had become too expensive for the state to bear. WTO entry will also push the government away from purchasing grain at protected prices, which are often above international prices. As the World Bank has pointed out, Indonesia and India have stabilized grain prices by procuring only 20 to 25 per cent of marketed grain. The policy shift also needs to be viewed in light of the slowdown in rural incomes over the last couple of years. While *per capita* rural income rose in 1998 by 4.5 per cent to 2528 *yuan*, in 1999 it almost stagnated at 2556 *yuan*.

Thus, despite extraordinary progress in economic reform, China's leaders face enormous future challenges. These stem from the problems of delayed reform and will provide a major test to the skills of the next generation of leaders. While there are grounds for pessimism, China has survived remarkably well to date and has avoided the various doom-laden scenarios that have been offered abroad. On the positive side, there is broad recognition that there is no alternative but to move ahead and in the latter half of the 1990s China's leadership has moved to a more comprehensive vision of the nature of reform and has begun to adopt a better sequencing for the reform program.

### ***The Challenges to Governance***

Equally as daunting, if not more so, are the consequences to governance of China's shift toward a market framework. While it is untrue to say that there has been no political reform to date, it has been limited and may not be sufficient to cope with the challenges of further international integration, the breakdown of the monopoly on information flows, the rising

corruption within China's system, and the increasing social differentiation that the economic reforms have caused.

This is not to say that China needs to move to a multi-party democracy overnight, it may not even be suitable, but throughout the system there are problems with the current governing structures and increasingly, good governance is recognized by local leaders as a prerequisite for further development. It is clear that the next phase of reform will require more substantial change in what government does and the role of the CCP in the political system. First, and foremost, the state needs to provide the institutional and legal framework for voluntary economic and social interaction to take place and it needs to ensure application. This lies behind the recognition of the need to strengthen the rule of law rather than rule by law, which can be interpreted as a mechanism to perpetuate party control in a changed socio-economic environment. Second, reform is deeply contested and competent government is required to adjudicate on difficult questions of the redistribution of power and resources from one sector of society to another. This can only happen effectively when the political system is opened up to different groups and interests and where citizens view the government as a relatively impartial arbiter. The major problem in this respect is that the party often substitutes for the government and is the major political player. This undermines any notion of impartiality in the political process.

Beginning a process of serious political reform would have a number of benefits and would facilitate dealing with a number of problems. First, it could help strengthen the legitimacy of CCP rule. Legitimacy currently is based on the capacity to deliver the economic goods and the leadership is casting around for other sources. Thus, we see the strident appeals to nationalism and patriotism and the fascination with neo-Confucianism. A more democratic

system would provide a residual legitimacy that might help the regime negotiate the difficult transition ahead. There is interesting empirical evidence from the countries affected by the Asian Financial Crisis that those with more open and accountable political systems have rebounded the best.

A significant problem for the current leadership is the inability to articulate a vision of China's future. The need to cover policy direction with the figleaf of socialism has made it difficult to outline what the future society would look like and how the relationship between state and society will change. The CCP cannot provide a moral framework for society meaning that the centrifugal tendencies can increase. People are more likely to seek spiritual guidance in alternatives or simply adopt a 'me-first' or 'family-first' approach to life. The breakdown of a civic morality in the Cultural Revolution has led to a highly instrumental view of inter-personal relations in the present. Presenting a shared moral vision is a major challenge for the CCP, and one that it is unlikely to deal with. The moral vacuum, however, presents a problem for any future leaders as there is no civil society that might provide a bond in the case of CCP collapse. We are more likely to be confronted with the 'uncivil society' as in post-Soviet Russia.

It is also difficult to see from where a new counter elite would emerge. The CCP has always moved to crush any organizations that might develop an alternative to its political rule. As a result, it has effectively fulfilled its own prophecy that without the rule of the CCP there would be chaos. Two challenges remain for it to keep this grip on power. First, it must continue to co-opt new élites to prevent them from forming political opposition.

Incorporation within the existing power structures of the new entrepreneurs and private business people is vital to CCP rule but it is still resisted by some who claim that it would

totally change the nature of the party. They may be right but the days are gone when the CCP would rely on claiming to represent the traditional working-class and the peasantry to justify its rule. Second, the CCP has to ensure sufficient economic growth not only to minimize instability in society but also to prevent differences within the elite about the future policy from becoming destructive and spilling over into society. This is what happened in the 1960s and in 1989 and these have been the only times that party-rule has been seriously challenged. Thus, unless there is a systemic crisis that causes the elite to fall apart, the CCP will control the nature and pace of political change. Only such change that is in its own interests for self-preservation will be undertaken.

There are, however, pragmatic benefits that would derive from political reform in ensuring a better environment for the economy and helping mediate potential social unrest. A system that would make local officials more accountable to the populations they are supposed to serve would be of immense benefit to virtually all concerned. Currently, Chinese reform attempts have concentrated on making the system, particularly at the local levels, more transparent. This has included: the new tax regulations that provide a clearer idea of tax revenue streams and what should be divided between the different administrative levels and the ratio of the division; and the public posting of village and township government accounts and financial information about officials. However, there has been less attention paid to making the system more accountable. Incomplete transparency without accountability will not provide a basis for the reduction of the systemic corruption that plagues China. One fruitful area to expand accountability would be to raise the level of direct elections from the villages to the township and county administrative level.

The economic development strategy is producing one of the least egalitarian societies in Asia, a supreme irony given that the ruling party still calls itself Communist. There is enormous inequality in the provision of public goods and services and the attendant corruption has sparked many demonstrations against autocratic local leaders. A more open political system that increased citizen participation would provide an alternative to rioting and other non-sanctioned forms of political action. The lack of accountability can also lead to government policy being re-directed or to perverse outcomes that undermine the intent of the original policy.

The conditions for long-term social stability are not likely to improve unless the party trusts its people to organize themselves to provide more and better social services and if the party itself does not reform and change significantly its relationship to state and society. With the decreasing financial capacity of the state, the decline in the party's moral authority, the downsizing of the work-force, and with more individuals increasingly responsible for their own welfare provision, the party will have to allow more autonomy to society to organize and prioritize its own affairs. Not to do this will mean that many needs will go unserved as the state cannot provide adequate services. This will, in turn, lead to an increase in the kind of unrest that the party seeks to avoid.

There will only be limited success in providing good governance unless the party itself undergoes substantial reform, as there is no other political force to turn to. There are factors at work that will undermine the economy and social stability that will require political change to accommodate them. Most of the general issues have been well covered: the need to develop an effective legal system that enjoys autonomy from party interference, separation

of party from government and enterprise, the acceptance of an independent social realm that would cover the right to organize and to establish a free media.

The political challenges are increased by the nature of China's involvement with the world outside and the pressures of globalization. It will take enormous skill on the part of the current leadership and its successors to prevent the challenges from undermining further the power and legitimacy of the CCP. To date, while the leadership has shown itself to be adept at adapting to economic change, it has not displayed the necessary skill at confronting the social and political consequences that arise from this change. Each time that the need for far-reaching political reform is floated, the senior leadership has backed away, hoping that its authoritarian power structures will enable it to crush any overt opposition and ride out any unrest.

Those who take power at the 16<sup>th</sup> Party Congress (2002) will not be able to rely on traditional CCP methods for controlling the country and will be under considerable pressure to find new ways to manage the Chinese polity. It is clear that the forces of globalization will require a considerable shift in the way the CCP governs the system and will require political reform that not only seeks to make the system more transparent but also more accountable. They will have to deal with a much more fluid domestic and international political order where many of the key decisions affecting China will be taken by international organizations that will not respect the CCP's outdated notion of sovereignty. Given its record to date, this will be a significant hurdle for the current leaders to overcome. Thinking that they have learned the lessons of their fast developing neighbors in the region, political coercion has been applied in fits and starts, combined with growing economic liberalization. However, this is a misreading of development and also is unlikely to produce a stable environment for

the future. The requirements for China for continued high growth are high information, declining coercion, less hierarchy, and more accountability by means of representative institutions and a marketplace in which priorities of goods and services in the economic sphere are balanced by needs and wants in the political sphere.

To be successful, the CCP has to lower the expectations of the urban-working class, something that it has been doing quite successfully. At the same time, the CCP must find ways to integrate the newly emerging social forces into the economic and, ultimately, political power structures. This has been particularly contentious with respect to the private business sector, much of which is concealed as collective or state enterprises. The CCP has steadily ceded more ground to the private sector of the economy, recognizing that it has been one of the main driving forces for economic growth and that it will benefit from greater international economic integration. Whether the Chinese leadership can deal with these challenges of governance will attest to whether it can retain its leadership over China's development in the 21<sup>st</sup> century.

---

## References

- Baum, Richard (1994) *Burying Mao. Chinese Politics in the Age of Deng Xiaoping* (Princeton: Princeton University Press)
- Dutton, Michael (1998) *Streetlife China* (New York: Cambridge University Press)
- Economy, Elizabeth and Michel Oksenberg (1999) *China Joins the World. Progress and Prospects* (New York: Council on Foreign Relations Press)
- Goldman, Merle and Roderick Macfarquhar (eds) (1999) *The Paradox of China's Post-Mao Reforms* (Cambridge, MA: Harvard University Press)
- Naughton, Barry (1995) *Growing Out of the Plan: Chinese Economic Reform, 1978-1993* (New York: Cambridge University Press).
- Nyberg, Albert and Scott Rozelle (1999) *Accelerating China's Rural Transformation* (Washington, DC: The World Bank)
- Oi, Jean C. (1999) *Rural China Takes Off: Institutional Foundations of Economic Reform* (Berkeley: University of California Press)
- Saich, Tony (2001) *The Politics and Governance of China* (Basingstoke: Palgrave)
- Steinfeld, Edward (1998) *Forging Reform in China: the Fate of State-owned Industry* (New York: Cambridge University Press)
- World Bank (1997) *China 2020. Development Challenges in the New Century* (Washington, DC: The World Bank)