

China's swing from a planned Soviet-type economy to an ingenious socialist market economy: An account of 50 years

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1. Introduction

China has evolved in twenty-five years, from a small, Soviet-type centrally planned economy into a more market-oriented economy, capable of competing worldwide and assuming a leading role in the years ahead

At over 9.6 Km² China is the third largest country by area accounting a population of 1,3 million souls according with the census of 2000 which makes her the world's most populous nation. The PRC is in 2005 the world's second-largest economy after the US and has a seat as permanent member of the UN Security Council; is the third largest exporter and importer in the world; is the world's biggest consumer of copper, tin, zinc, platinum, steel, and iron ore; the second biggest of aluminum and lead; the third largest of nickel. China is the world's second-largest-oil consumer, after the United States and account for 35 percent of world's cameras and 30 percent of air conditioners and TV's reports the *Asian Development Bank*.

China has been experimenting since the 80's a sustainable economic growth, with an increase of its Gross Domestic Product of more than 9% a year, in average. In 1997 the World Bank publish a study *China 2020: Development Challenges in the New Century*, that project China's long term average annual growth at 8.4% for 1996-2000, 6.9% for 2001-2010, and 5.5% do 2011-2020².

China has met largely these targets in the first third of the period monitored and has experimented since 2000 a growth of its GDP about 8 % en 2000, 7.5 % in 2001, 8 % in 2002 and 9.1 % in 2003, according with international data³. Due to its large and stable population, its rapidly growing economy and military spending and capabilities China is increasly looked as a world power and by this fact raises contradictory perceptions in its neighbors, rivals and competitors.

This ascent of China to a primary role in the next decades hoists many important questions. How the West will accommodate to this economic and political climb? What strategy China's neighbors will choose: a "containment" approach or a friendly but prudent partnership? And, finally, how China will act internationally when becomes a geopolitical power capable of projecting its military and economic magnitude?

After the unquestionable success of the economic reform process implemented since 1978 under the leadership of Deng Xiao Ping the CCP is confronted with a major challenge to deepen the structural reforms and extend them to the political sphere. Economic development has generated large disparities in per capita income between regions, being the coastal provinces more favored than the interior. The new political leadership, usually named the Fourth Generation, and headed by President Hu Jintao, has struggled to sustain adequate job growth for ten of millions of workers laid off from state-owned enterprises, combating corruption and similar economic crimes and seize the environmental damage coming from the economy's rapid transformation.

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² See World Bank, *China 2000: Development Challenges in the New Century*, Washington, DC, World Bank, 1997; *Global Economic Prospects and the Developing Countries*, Washington, DC, 1997.

³ See *China-Economic data*, in www.economist.com/countries/China/

Around 180 million of rural workers are adrift between villages in the central China and cities in the East coastal area, subsisting through low-paying jobs.

The challenges China faces are Herculean and extraordinary and there are no anticipated guarantees China could meet them, successfully. In recent years, a pragmatic approach of whether-it-is-a-black-cat-or-a-white-cat-as-long-as-it-can-catch-the-rat has proved to be a safety net for China to reach the economic targets, that were planned and help to silence the ideological motives that capture China in poverty and backwardness. In this article I look to review three decades of growth, transformation and opening to the outside world.

2. The construction of a socialist state

After defeating the Kuomintang army in a civil war that lasted from 1927 to 1948, interrupted by a short period of national unity against the Japanese invasion between 1936 and 1945, Mao Zedong founded the People's Republic of China on October 1st, 1949.

Inheriting a bankrupt economy with soaring rates of inflation, agriculture in a state of collapse, suffering chronically from a system of land property and arbitrary and inhuman exploitation, hunger in the fields and void exchange reserves, the new government initially concentrated its efforts on rehabilitating a country devastated by the civil war.

It's no surprise that the first measures taken were concentrated in the area of price and wage stabilization through the introduction of a new national currency, the "*Jemin p'iao*", which replaced the role of foreign currencies as the medium of exchange.

Supporting a rural-based economy, the government tried to establish a new economic structure. According to "The Common Programme" approved by the Political Consultative Conference (CPPCC)⁴, the economy was to consist of three sectors: the state sector, in which the government would control the big industries, the mines, public enterprises and utilities; the agricultural sector, made up of individual farms that would be gradually transformed into collective units; the private sector, constituting of businesses of medium size which would remain in the hands of small and medium capitalists.

Of the three, the state sector was to assume the position of economic leadership, combining the roles of engine and catalyst in the national productive process to prevent the resurgence of the private sector, source of the "old relations of production" overcome during the revolution⁵.

The nationalization of foreign interests in the industrial sector was, from the beginning, a clear aim of the new government.

It is important to bear in mind that China was characterized by small, highly labor-intensive enterprises. The most modern sector of industry was in foreign hands and concentrated in industrial pockets around the principal ports and coastal cities, which had led to the impoverishment of the interior of the country and the chronic underdevelopment of the transport and communications infrastructures.

The national process of rehabilitation, therefore, presupposed the confiscation and nationalization of businesses under foreign control, as well as the big enterprises

⁴ The CPPCC was set up by the Chinese Communist Party at the beginning of 1949 with delegates from more 20 organizations and groups with the objective of constituting a united front to form a legislature necessary for the institutionalization of the new regime. The CPPCC has, since then, formed the symbol of propaganda of the coexistence of the CCP with the so-called "democratic patriot parties".

⁵ See Mao Zedong, from, "On the New Democracy", p. 576, *Selected Works*, Vol. II, Foreign Languages Edition, Beijing, 1971.

in the metallurgical and heavy industries, which were owned by entrepreneurs close to the Kuomintang party.

It also presupposed the continued private ownership of small and medium sized enterprises, considered by the communists as strategic allies in the revolution and indispensable for the reconstruction and massive industrialization of the country.

But the definitive issue was the question of the system of land ownership and how to confront with a new style of class relationships in agriculture that had so marked and governed the way of life of the rural population in the past.

The peasantry was (and is) the most numerous and important class in Chinese society and gave decisive support to the communists in winning the civil war.

As in other parts of the Third World, *Agrarian Reform* was the most delicate issue of the Chinese revolution and the issue, overall, on which its success rested.

The *Agrarian Reform Law* approved in the early 50s had three aims: firstly, the abolition of the feudal ownership system and the neutralization of the rural landlords - the dominant elite and traditional hub of imperial society and the mandarin system, from which, as the communists understood it, originated the humiliations suffered by millions of poor rural dwellers; secondly, the redistribution of the land to the poor peasants which were the main core of the rural population; thirdly, the protection of the interests of the small and medium farmers and their isolation from the influence of the landlords, in such a way as to ensure the supply of food to the Chinese population and the reduction of supporters for the old system.

The first decade of the People's Republic of China would, nevertheless, be classified in terms of the emerging economy model as a result of the strengthening of *central planning* mechanisms, assimilated from the Soviet experience of 1928-41, and the prioritizing of the industrial sector, specifically heavy industry, in the role of economic leadership.

At the top of the system there was a *Planning Authority* consisting of a group of economic planners. The planning authority had control over all physical productive resources, including land, buildings, machinery and other capital goods. Directly or indirectly, it controlled all enterprises, farms and factories.

The national plan had a five-year scale, so innumerable ministries and state departments were created to respond to the needs of controlling and supervising each industrial sector, thereby creating a vast bureaucratic network which hindered the capacity for decision-making, an indispensable factor in the rectification of production errors⁶.

Consumer goods targets were the last to be set. "Rationed goods" (food, grain, vegetable oil, meat, sugar and cotton cloth) were distributed to consumers through a rationing system. "Non-rationed goods" were sold through stores operated by the planning authority.

In the logic of the system, those goods and products which weren't considered targets of the planning authority weren't therefore necessities which required fulfilling for the central supplying system and weren't available to the population.

A factory workers income depended on the wage rate that the authority determined. The system operated as life insurance to the extent a worker could not be dismissed and the factory was a small welfare unit that provided the worker and his family with what they needed to survive.

Each farmer received a fraction of the net income of the farm according to the points that each received annually, according to his work assessment.

⁶ As James M. Ethridge states in "*Changing China*", New World's Press, Beijing, 1988, p. 279, "in a textile or basically equipped metallurgical factory there was a minimum of five to six levels of responsibility. In the case of one big industrial project, the authorization of 860 different offices and government departments was required for final approval".

The First Five-Year Plan was drawn up in 1953 but only truly came into operation in 1955. It envisaged the construction of 694 factory units (156 of which to be built under the Soviet Aid Treaty) and laid down the objectives of doubling industrial output by 1957 and transforming agriculture along socialist lines.

By 1957, not only had the objectives of the plan been reached but also they had been surpassed, prompting the government to implement a new, more ambitious five-year plan for the period 1958-62. Industrial production was to be increased by 75 percent, agricultural by 35 percent and national income by 50 percent. Development was to be concentrated on strengthening the industrial base, specifically heavy industry, on the more widespread application of national technology and on the gradual collectivization of land and its consolidation as the "property of all the people"⁷.

The reform of agriculture took new steps forward through the 50s as Mao made up his mind to follow an autonomous course - despite opposition from the soviet experts - with the gradual and phased collectivization of the land. More than 120 million acres had already been redistributed to the peasantry in the implementation of the Agrarian Reform programme.

Mao believed that the collectivization of land should be pursued through medium-scale experiments, gradually enlarged to bigger areas, through cooperation of the peasants in a beneficial mutual base and through indoctrination of the masses and assistance from the state and the Party.

By the first half of 1957, the reform of agriculture and the socialist transformation of a large part of private enterprises had been firmly achieved.

Under the pressure of the success of the First Five-Year Plan, the Chinese planners convinced the leadership to implement "burn phases" in economic growth and define a new plan for the 1958-62 periods with higher growth rates.

3. The Great Leap Forward

In 1957, the National People's Congress approved the "*Great Leap Forward*" and amended the objectives set in the five-year plan, amounting to a 19 percent rise in steel production, an 18 percent rise in coal and electricity production and an overall 33 percent rise over the initial figure for proposed industrial output.

Political approval for the programme was followed by a national campaign to "mobilize the masses" to achieve its objectives, in the belief that the rightness of the political line and the energy of the masses would overcome all difficulties.

This involved transferring the peasantry to the factory and manufacturing work, creating a species of agricultural-industrial proletariat that worked in improvised furnaces in the back courtyard of Chinese homes to support the industrialization effort. The campaign was termed "*running on two legs*".

In agriculture, the task of the "Great Leap Forward" was the creation of the People's Communes, which, by the end of 1958, amounted to around 26,000 and embraced 98 percent of the farming population, which had been transferred from their own lands to the new sites. The communes were not only productive entities but also the rural centers of the new socialist power and thus responsible for intensifying the collective dimension of socialist life. At the same time, they were the local

⁷ By 1956, five economic sectors had emerged from the fall of the feudalistic imperial system: the state economic sector, driving force behind the national economy and its social focus: "under the ownership of all the people; the cooperative sector, mixing cooperatives based on the private ownership of the means of production and others owned collectively by the workers; the individual sector comprising the activities of individual farmers, artisans and other independent workers; the private capitalist sector, in the hands of the national bourgeoisie; the state capitalist sector, comprising private businesses in capitalist ownership but under worker control. The coexistence of these sectors, during the first years of the revolution, revealed the transitory nature and gradualism of its initial phase in comparison with the suddenness of Bolshevik appropriation and nationalization.

administrative organs of the state, controlling the collection of taxes and operating schools, hospitals, banks, public kitchens, shelters and other social welfare units⁸.

By the end of 1959, it was clear that the Great Leap was an economic, political and social catastrophe and almost 20 million people lost their lives in the Party adventure as famine spread again through China. Government administration was in chaos and statistics were falsified wildly due to the ideological pressure placed by the central authorities on the production units.

Despite the tragedy, the Communes were the longest-lasting innovation introduced by the Great Leap and, relative to the Soviet socialist experience, something that definitely distinguished China from its nearest rival. They survived until the mid 1970s regulating the work, education and political life of 600 million people.

In 1960, the Soviet Union cancelled all its technical, financial and human assistance to China. Soviet experts left suddenly, deserting equipment and 250 half-constructed industrial plants.

Once again, China found itself alone.

4. The new economic pragmatism and the ideological set-back

In the new conditions created by the political divorce between the Soviet and Chinese leaderships, the pragmatism of the Chinese planners was reflected in a new strategy for industrial and agricultural development for the next decade, under the policy "*readjustment, consolidation, filling-out and raising standards*".

This period reveals the search for an ordered system of planning that could better combine management capabilities, technical expertise, management skills and worker responsibility with financial incentives, all factors understood as relevant for increasing and improving productivity. Profitability and technical efficiency become newly emphasized concepts to the detriment of moral incentives, emulation of the socialist mystique and ideological reward.

It is finally understood that the national economy cannot be ruled from the center, by the central government, in the Soviet manner. Control need to be decentralized to the provincial governments, as a way of promoting and favoring the capacities and responsibilities of managers, technicians and workers.

In industry, priority is transferred to the production of consumer goods to assist the population in its subsistence; differences in salaries widened within companies by way of a bonus system and profitability became the general criterion of evaluation of company performance.

The pragmatism of this new approach is summarized by Deng Xiao Ping's famous slogan: "*It hardly matters whether a cat is black or white, as long as it catches mice, it is a good cat*". This down-to-earth philosophy revealed the desire of the pragmatic wing of the Party, unconvinced by the self-criticism of Mao at the enlarged Lushan conference, to balance the experiences of the Great Leap.

In the agricultural sector, new rules are established under the campaign of "*Three privates and one guarantee*", "*San-tzu i-piao*", which reintroduces the possibility for farmers, while remaining commune workers, to simultaneously cultivate their own private plots (5 percent of arable land), operate small handicraft businesses and sell their products at the rural free markets. The "one guarantee" was the obligation on farmers to fill the production unit quotas established by the central government.

⁸ James M. Etheridge in "*Changing China*" mentions "some 26,000 communes were organized from 740,000 advanced co-ops during 1958-59 in the frenzy of the Great Leap Forward. They were large compared to co-ops, ranging in size from 15,000 persons to perhaps 30,000 or more in metropolitan suburbs and very productive areas. Creation of the communes from advanced co-ops involved drastic, indiscriminate transfer of the assets of the former co-ops to the commune without compensation to co-op members, who had owned their assets, and without consideration of fairness. It also involved the abolition of private property.

The introduction of these new rules mixing central planning rationality with elements of a free market economy reveals the widening of the economic base of Chinese society and points to a clear change in the direction of the revolutionary programme to meet the needs of the majority of the population.

In December, 1964, at the Third National People's Congress, Zhou Enlai, Mao's prime minister, attempts to evoke political support for the *Four Modernizations* - industry, agriculture, defense, science and technology - as the core of China's approach to development.

The attempt fails, however, and the ideological confrontation within the Party worsens.

The New Leftist uprising, the *Cultural Revolution*, began in 1965. The economic and administrative systems come under attack from millions of Red Guards that defy the legitimate power structures, transferring power into the hands of the radical elements, and proclaim the destruction of the old culture/leadership and the emergence of a new one over its ashes.

The political programme of this uprising concentrates on three points: *firstly*, economic development must not surpass loyalty to the official ideology that led to revolutionary victory; *secondly*, its ideals must be raised and kept alive through the ideological reeducation of Party cadres and the state *apparatus*; *finally*, the class struggle must continue within the Party and the masses must be alert to the activities of *anti-revolutionary roaders* and denounce them, whoever they are.

The social and political tumult which ensues as a result of the complete breakdown in the functioning of official institutions and the workers demands for higher salaries leads to the decision to freeze prices at 1965 levels until 1966. This freeze would continue until the mid 70s and prevent the functioning of price controls, generating underground inflation.

In 1969, the Ninth CCP Congress declares the end of the Cultural Revolution. Its consequences would remain through out the 70s, however.

In January 1975, Zhou Enlai renews his call "for an independent and relatively industrial economic system" to be created by 1980 and for a general update of those sectors of the economy pinpointed in the *Four Modernizations* by the end of the century. This speech, which is considered the political basis for a new development programme, meets opposition from the *Gang of Four*,⁹ which denounces the strategy as "the path towards restoring capitalism" and as treason to the Party and Mao. Deng is again dismissed from all his posts in the Party and state as a "*capitalist roader*".

Mao dies in September 6, 1976, having failed to resolve the problem of the continuation of the political legacy. Power is formally transferred to Hua Kuofeng, Mao's last heir, but he fails to carry on the ideological leadership.

5. The program of the "Four Modernizations"

At the first session of the Fifth National People's Congress, in February 1978, Hua Kuofeng announces a big modernization programme, the Ten-Year Plan of 1976-85, encompassing agriculture, industry, science and technology and national defense. Despite an eight year projected time span, however, the plan sets out very ambitious objectives.

For industry, the following objectives are set out: a massive investment equal to the total for the entire proceeding 28 years; a ten percent growth rate per sector; the completion of 120 big industrial projects (including oil pipelines, energy storage centers, ports and dams); an increase in steel production to 60 million tons by 1985

⁹ A pressure group formed around Jiang Ching, Mao's wife that led the Cultural Revolution on behalf of Mao and was responsible for the liquidation of Liu Shaoqi.

and 180 million tons by 1990; the opening of 10 new oilfields (at a cost of 60 billion US dollars); the opening of new coal mines and 30 power stations¹⁰.

For agriculture, the objectives are the following: the maximization of agricultural production through mechanization, electrification, irrigation and better utilization of chemical fertilizers, as well as the statistical increase of production by 4 to 5 percent by year; an increase in output of food products from 285 millions tons in 1977 to 400 millions by 1985; the mechanization of 85 percent of farm work; the expansion of water works to assure an extension of irrigated land by 121 million acres; the establishment of 12 base production zones for food products and consumer goods; modifications in the system of production incentives and the widening of permission for use of family lots for private purposes (accounting for 25 percent of agricultural and subsidiary production)¹¹.

Science and technology is established, for the first time, as being fundamental to the modernization of the other economic sectors if China is to be, as projected, only ten years behind more developed nations in 1985 and in the group of advanced nations by the end of the century¹².

China had, in terms of military power, the world's largest regular army in 1978, but with the exception of strategic weapons (nuclear bombs and ballistic missiles), military technology was twenty years behind the West. The army was politically indoctrinated with the concept of *people's war* and people's war tactics but had neither funds nor modern military equipment, both at the defensive and offensive levels.

While realizing the astronomical cost of replacing obsolete equipment, the new leadership nevertheless recognized the urgency of such an undertaking and consequently the modernization of the PLA was established as a national priority¹³.

The immense investment demanded by the implementation of the Ten-Year Plan led, in its initial year, to the absorption of the equivalent of 36 percent of the GNP which, when added to the demand for available financial resources, i.e. foreign currency, and the lack of technology and scientific resources, forced the leadership to re-evaluate the objectives of the plan and reorder its priorities, moving agriculture into first place, light industry into second and heavy industry into third.

In December 1978, a three-year period from 1979 onwards is established for the consolidation, reconstruction, adjustment and improvement of the economy coinciding with a dramatic cut in public investment and a slowdown in the pace of modernization. At the same time, the budget deficit doubles and the unrealistic estimates for oil production and exports make the introduction of more sophisticated and detailed planning techniques, a matter of urgency.

The final *communiqué* states that China will deepen economic cooperation with foreign countries.

¹⁰ Immanuel C. Y. Hsü "The rise of modern China", Oxford University Press, New York, 1990, 698-703.

¹¹ Immanuel C. Y. Hsü, *ibid.*

¹² According to Hsü, *ibid.* The National Science Conference, which took place in March, 1978, established a Draft Outline Plan for the Development of Science and Technology with the following objectives: (1) to achieve or approach the levels of development of the advanced nations in 1970, in different areas; (2) to increase the number of scientific researchers to 800 000; (3) to develop modern research and development centers; (4) to set up a national system of technological and scientific research. The plan identified 108 key projects in 27 areas.

¹³ Jonathan Pollack, in "China's four modernizations", edited by Richard Baum, Boulder, 1980, p. 247, refers to the fact that although China's defense budget was a state secret, it was evaluated in the West at around 32,8 billion US dollars in 1976, the third largest in the world at that time. Another source estimated in 1978 at about 7-10% of Gross National Product, equivalent to 35 billion US dollars.

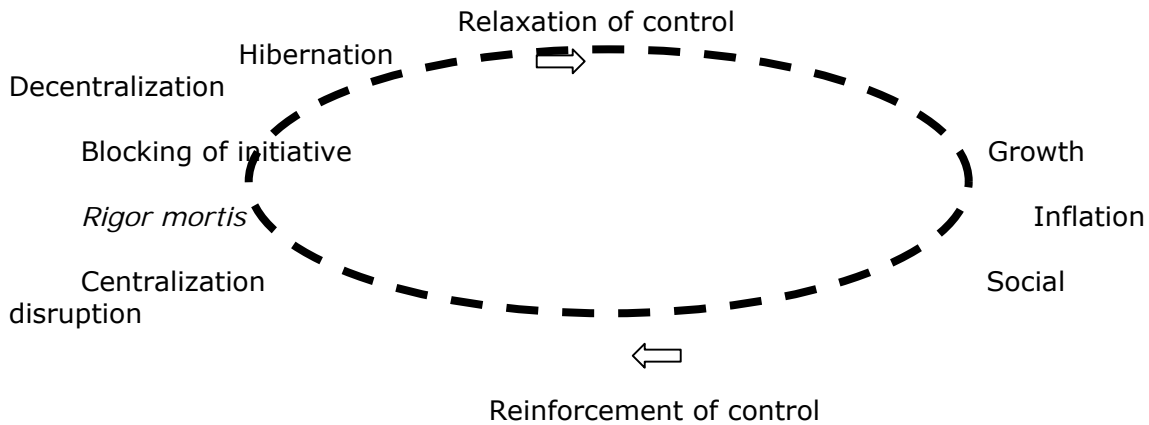
The trial of the *Gang of Four* between November 1980, and January 1981, marks the end of revolutionary revivalism and foresees the rehabilitation of the economic and political system.

In 1982, the PRC establishes normal diplomatic relations with the United States. Foreign trade and foreign investment become China's development priorities. From 1977 to 1979, the value of exports and imports almost doubles, representing real economic growth of 17 percent.

However, the question of the definition of the *model* of Chinese economic development continues to separate those who wish to reestablish the socialist order, the heirs to the dominant political thought, the *whateverists*, from the reformers organized around Deng Xiao Ping.

It will be useful to note at the end of this chapter that the strategy followed by the CCP in building socialism was neither homogenous nor linear, but instead revealed a typically Chinese approach of "trial, error and correction" towards the conducting of state affairs, clearly different from the archaic Soviet planned economy system.

The various phases that composed this strategy (or strategies) of economic development followed a *circular course* composed of movements of expansion, retraction and then consolidation after a campaign of political "rectification" had been undertaken, during which specific liberal economic policies were severely criticized as well as those responsible for them. The following diagram reveals this trend:



6. The inner circle debate about China development model

The intervening period between Mao's death and the Fifth Plenum of the Eleventh Central Committee in February 1980, is a decisive time in the recent history of China. It witnesses the de-Maoification of the regime and the consolidation of power in the hands of the pragmatic wing of the Party and the final breakdown of the radical element.

In November, 1976, Hua Kuofeng, Mao's designated successor, after assuming power, announces the rehabilitation of Deng and the revision of the Fifth Five-Year Plan aimed at speeding up the Four Modernizations. Despite the positive signs the new leadership generates by these initiatives, a confrontation arises between three different visions of the future development of China.

a) Hua kuofeng's "continuity" path

Hua Kuofeng affirmed that for China to achieve fast economic development, no reform of the economic and political systems was required. It would only be necessary to resume the model prior to the Cultural Revolution, restoring the social order and decentralizing economic decision-making power onto the regions and the local *apparatus* of the state.

This, in other terms, represents the recognition of the "political rightness" - as we categorize it today - of the role of traditional mandatory planning in guiding the Chinese economy and allocating resources.

b) Chen Yun's major beliefs

Chen Yun was the father of the First Five-Year Plan and a planning expert who was especially fond of Soviet planning traditions.

Chen believed that socialist planning was needed to conduct the Chinese economy and that the failures of the past two decades had been the result not of the system itself, but of the mistakes made in its application and the lack of control. China was too poor and its population too big to produce enough goods to satisfy demand. Opening the market too quickly would cause uncontrollable inflation and pull resources away from top-priority national development projects for others of low productivity. China should continue to trust in the mechanisms of price and budget-deficit controls, as in foreign trade.

In an achieved analogy, Chen referred that a bird cannot be held tightly in one's hand because that would kill it; it must be allowed to fly. But it must be allowed to fly within its cage: without the cage it would fly away.

The bird represents economic revitalization - the market - and the cage represents state planning.

c) Deng Xiao Ping's vision

Deng, on his part, stressed that the progress of the country had been blocked by systemic problems in the conducting of the economy, and by an irrational rigidity in the system that obstructed sustained development.

To achieve this development, a profound and ambitious programme of economic and structural reforms would have to be begun to lay down the foundations for achieving the *Four Modernizations* in the coming decades¹⁴.

Deng stressed that the guidelines for the political work of the Party and the government should be "Practice is the sole criterion of judging the truth and seeking truth from facts will overlap the political indoctrination of the masses".

In the eyes of the reformers, the fundamental issue in China was not to replace bureaucratic coordination with market coordination or public with private property, but to carry out something similar to a transplant onto the ageing central planning authority of new, more skilled, "blood". In other words, to cautiously bring to the market and quasi-privatize the more desirable organs of the system, to improve the circulation of information and stimulate the system and thereby lessen the waste, increase efficiency, guarantee state revenues and preserve social stability¹⁵.

The inner-Party debate concludes with the victory of Hua Kuofeng's position, as the core leadership stands fearful of facing the risks of unleashing new forces to modernize the country.

The process of economic modernization begun in 1979 can be divided into two stages: the first, which lasts till 1984, sees the concentration of reform in the

¹⁴ Deng stated in December 1979, that the objectives of the *Four Modernizations* was to quadruple the then GNP of 250 billion US dollars to a figure of one trillion by the end of the century, equivalent to the value of 1000 dollars *per capita*. Later he would maintain this goal while readjusting GNP per capita to 800 dollars in response to an increase in population to 1,2 billion. See *Building Socialism with Chinese Characteristics*, Foreign Language Press, Beijing, 1985.

¹⁵ According to Ezra F. Vogel, in *"One step ahead in China-Guangdong under reform"*, Harvard University Press, London, 1989, p.77, Deng create a *think tank* in 1979, the *Commission for the Reform of the Economic System*, headed first by Zhao and later by Li Peng, with the objective of leading the reform process and defining its outline while leaving practical measures to the creativity of local and regional structures.

countryside and agriculture in order to calm the expectations of the peasantry, the eternal barometer of the Chinese revolution.

The second tries to make the juxtaposition between the forces of reform and the entire economic system, with a particular emphasis on the economic modernization of the cities and the principal urban centers, in direct contact with foreign markets. It is this stage that China is currently living through¹⁶.

On the 8th of July 1979, China adopts a new "Law on Joint Ventures using Chinese and foreign capital" and takes decisive steps toward opening up to the outside world.

In the political arena, Hua Kuofeng steps down in May 1980, from his position as president of the Party and prime minister while temporarily maintaining his place as chairman of the powerful Military Commission of the Central Committee. Deng is elected to a collective leadership constituted by Hu-Yao Bang (secretary-general) and Zhao Ziyang (prime minister), at the Third Plenum of the Fifth National People's Congress, in September 1980.

The triad or alliance - military-Party-government - that this symbolizes would be (and will be) the key factor in the balance of power and survival of the leadership in China until the end of the millennium.

7. The *smooth revolution* of Deng Xiao Ping

The changes advanced so recklessly by Deng Xiao Ping will be registered as China second revolution, or China's *smooth revolution*. It is a process of radical change that falls outside the traditional theoretical/political framework of capitalism versus socialism, but deepens earlier experiences to enshrine new grades of evolution in transitional political models. Deng named it *socialism with Chinese characteristics*¹⁷.

Deng state, as the fundamental part of his political programme, an "*open-door policy*" (*kaifang zhenze*) as stated in the communiqué of the third session of the Eleventh Central Committee in December 1978¹⁸¹⁹:

¹⁶ Jan S. Prybyla refers in "Mainland China's Economic System: a study in contradictions"; *Issues & Studies*, August 1994, p.1-30, "The second reform was launched at the end of 1978 and is still in progress. It consists in the piecemeal, nonviolent dismantling of the bureaucratic coordination mechanism, or what was left of it in the wake of the Cultural Revolution, and of state and collective property, and replacing them with market coordination and various property combinations leaning toward the private. The analytical-ethical infrastructure is at this stage somewhat schizophrenic: officially, it is Marxist-Leninist-Maoist (the so-called "Four Basic Principles": socialist road, dictatorship of the proletariat, Party leadership, and Marxism-Leninism-Mao Zedong Thought); in everyday practice it is catch-as-catch-can "pragmatism".

¹⁷ Jan S. Prybyla, *ibid*, comments that the Chinese experience suggests that classical socialism can be seen as merely one of various historical social formations not immune to internal pressures of transformation as a means of responding to necessary changes concerning environmental problems and new technologies.

¹⁸ "Comuniqué of the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China", *Beijing Review*, n.º 52, December 29, 1978.

¹⁹ Deng refers in "*Fundamental issues in present-day China*", Foreign Language Press, Beijing, 1987, p.79, "Foreign worry that we may change our policy of opening to the outside world. I have said it will not change. I have told them that our first target covers the period between now and the end of the century and that we have a second target to achieve within 30 to 50 years or maybe longer, say 50 years, in which this policy will not be abandoned. Isolation prevents any country's development. We suffered from this and so did our forefathers. We must open ourselves to the outside world. It will not hurt us. Still there will be some negative effects. We must be alive to them, although there are not difficult to overcome. If we practice isolationism and close our doors again, it will be absolutely impossible for us to approach the level of the developed countries in 50 years. When our per capita GNO reaches several thousand dollars, no new bourgeoisie will emerge, because such essential things as the means of production will still

We are now...adopting a number of major economic measures, on conscientiously transforming the system and methods on terms of equality and mutual benefit with other countries on the basis of self-reliance, striving to adopt the world's advanced technologies and equipment and greatly strengthening scientific and educational work to meet the needs of modernization

The practical sense of the policy was that China could not continue to look inward and be apart from the world, but as to reinforce its links with the West in order to benefit from external *foreign direct investment* (FDI) that is the interest of international investors. This openness would attract foreign capital and fill national reserves necessary to sustain China's capacity to run into debt in the process of obtaining from the outside the technologies and know-how that it lacks and are indispensable for the modernization of the country.

In September 1982, the Twelfth Congress of the CCP defines as a basic objective of economic construction until the end of the century, the *quadrupling* of the gross annual value of agricultural and industrial production from 710 billion Yuan in 1980 to 2,800 billion Yuan by the year 2000 with the intention of placing China in front of all other nations in terms of gross national income and agricultural and industrial output.

Industrial production, agriculture, energy, transport, education and science are designated target areas and a two-stage process for their development is established. The first, up to 1990, aims at the consolidation of earlier efforts and the accumulation of capital and experience for the jump in growth planned for the second stage between 1990 and the end of the century. The reorganization of the economic system earns constitutional legitimacy with the promulgation of the new constitution of the PRC, on the December 4, 1982, by the National People's Congress²⁰.

Almost two years later, the Third Plenum of the Twelfth Central Committee outlines the details of the reform programme.

In agriculture, the following principles are laid down: respect for private property; the safeguarding of decisions taken by production brigades regarding the setting of objectives; the implementation of the principle of "each according to his work" in place of the distributive egalitarianism of earlier; the protection of farmers individual lots and the right to exploit them for private gain; the readjustment of prices paid by the state for agricultural products according to the cost of production.

A new *Responsibility System*, "*pao-kan tao-hu*"²¹ is set up under which contracts are signed between production brigades (the rural economic structure of state) and

be state-owned or publicly owned. And if the country prospers and the people's material and cultural life continually improves, what's wrong with that?"

²⁰ Article 6 of the 1982 Constitution states that "the basis of the socialist economic system of the People's Republic of China is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people". According to the legal text the economy is divided into four sectors considering the ownership of the means of production: (1) the state economy, the leading force of the national economy comprising mostly state enterprises; (2) the socialist laboring masses collective ownership economy, i.e., the people's communes and the agricultural producers cooperatives and factories or shops taking the form of collective enterprises in towns; (3) the individual and private economy comprising individual businessmen in rural and urban areas and private enterprises; (4) the sector of economy with foreign participation comprising Chinese foreign equity joint ventures, Chinese-foreign cooperative joint ventures and foreign capital enterprises. See *Constitution of the People's Republic of China*, Foreign Languages Press, Fifth Edition 2004 (First Edition 1987), Beijing, China.

²¹ According with Immanuel C.Y. Hsü, *ibid*, a lot of land is initially turned over to each farming family for one agricultural season or one year (with the possibility of being extended to fifteen

farmers which define production quotas and establish clearly the obligations between farmer and state. Concomitantly, efforts are made in the specialization of production and in the use of new agricultural techniques to better orientate output towards the internal market.

The results of the reform are nothing less than spectacular. The annual rate of growth in the production of grain increases from 2.1 percent between 1957 and 1978 to 4.9 percent between 1979 and 1984 reaching a record output in 1984 of 407 millions tons, transforming China, a traditional importer of agricultural goods, into an exporter of grain, soybeans and cotton and generating a trade surplus of 4 billion US dollars between 1980 and 1984.

At the same time, a clear vote of confidence is taken in the abilities of industrial enterprises to make decisions and govern them through the increasing professionalism of management. Factories are given the power to adjust production according to market demand, buy industrial equipment and raw materials on the market, and sell any surplus production once the fixed, state quotas have been met, at whatever prices they see fit. On top of the subsidies granted by the State²², enterprises are newly allowed to exploit a part of profits as their own resource, thereby altering the practice of delivering all profits to the central authorities. Other innovations are introduced in the area of business management flexibility and in worker's salaries in order to put an end to irrational practices, low productivity and waste. The idea, then, is to return the concept of *law of value* to the productive system.

An industrial *Responsibility System* is thus instituted whereby each state enterprise signs a profit and loss contract, "*Yin-k'ui pao kan*", with its supervisory and control body in which the production quota, the share of the profits to be handed over to the state and the application of the share remaining, are established.

Towards the end of 1982, almost all industrial enterprises are to be found working under this system. The sector continues, meanwhile, to represent a strong feature of heavy industry.

The reduction in state revenues that the retention of profits by companies and towns leads to, and the relaxation of control over its use, as a result of the decentralization of effective power to the local authorities, impels the central government to institute, in June, 1983, a new national tax of 55 percent of profits of large and medium-sized companies and a system of variable taxation on small enterprises.

years). The land remains in public ownership but production is defined by contract, which specifies the quantity of grain to be planted and the part of production to be handed over the production brigade as payment for use of the land. This payment also covers general expenses such as irrigation taxes, medical insurance and reform funds. In this way, every family has complete control over its human resources and is able to sell in the market place any production surpluses left once the state quota is filled. Each farming family has total responsibility over the production process, from choice of seed, employees, soil, until harvest. Later the system would be liberalized even further with the granting of permission for the selling of the use of land from one family to another.

²² The industrial structure put in place by Mao in the 1950s was inspired by the Soviet model and characterized by central planning and by prioritization of heavy industry. As the sole owner, operator and employer the state planned for, managed and funded all public enterprises. The state provided land, plants, equipment, basic materials, working capital, managers and everything else throughout the entire process of production. It also established the prices of finished goods without taking into consideration either costs or levels of quality. As Immanuel C.Y. Hsü refers "under this system, enterprises received state support regardless of their performance records, and the workers received their standard wages regardless of the quality of their work. A saying went, "every enterprise eats from the Big Pot of the state, and every worker eats from the Big Pot of the enterprise".

Reforms introduced in the urban economies exceed the most ambitious expectations of the five-year plan. Private and cooperative property ownership widens and the number of public, private and self-employed workers grows significantly. Companies look to the market and the needs of consumers. The role of planning is reconsidered, the market increasingly becoming recognized as the true regulator of the economy as it becomes more internationalized and the barriers to foreign capital, foreign ownership of property and foreign goods fall.

The facts coincide with the expectations. Industrial and agricultural production grows at the annual rate of 10 percent between 1978 and 1986 and national income at a rate of 8.7 percent. Capital investments rise from 25 percent in 1982 to 23.8 percent in 1984 and then reach 42.8 percent in 1985. Industrial growth is significant: 14 percent in 1984, 18 percent in 1985, 9.2 percent in 1986 and 16.5 percent in 1987. The various sectors of the economy contribute to overall GNP in the following percentages: agriculture (28.1), industry (53.7), construction (10), transport (3) and trade (5.5). Between them agriculture and industry generate some 42 percent of national income at 1985 values.

Another area in which the profound effect of the reforms is felt is in the *system of price controls*²³. In the mid-1980s a great decentralization takes decision-making powers over the use of resources out of the hands of the Party bureaucrats and into the hands of those directly involved in the economic process, i.e. buyers, sellers, consumers and producers, thus strengthening the relative sovereignty of spheres of economic decision-making outside the strict control of the state.

Rapid growth and rocketing production results in the overheating of the economy, confusion and increasing rates of inflation (12.5 percent in 1985, 7 percent in 1986 and 8 percent in 1987, according to official figures, which equates to 15-20 percent per year in real terms). The panorama of China's economy during the 80's and the first half of the 90's is the following:

²³ Jan S. Prybyla in *"Mainland China's"*, *ibid*, refers to the fact that while in the 80s, 70% of the value of consumer goods was subject to the rigid taxation system, in 1990, two-thirds of agricultural products, some 80% of manufactured goods, almost all services and a third of essential goods were sold at market prices. At the start of the period of reforms, the government set the exchange rate of the Yuan above its market value. In the mid-80's, the *Yuan* was devaluated more than once to adjust it in line with the market. Since 1991, the exchange rate adjustments have become more frequent.

Table I
Gross National Product and National Income

Year	GNP (1)	NI(1)	GNP (2)	NI(2)	NI/p. capita (Yuan)
1985	855.8	702.0	188.2	183.2	668
1990	1769.5	1438.4	272.7	263.7	1267
1991	2023.6	1655.7	295.0	284.0	1439
1992	2437.9	2022.3	334.5	327.7	1736
1995	3134.2	2488.2	378.7	377.2	2111

Legend: (1) (Prices constant/Billion Yuan; (2) 1978=100
Source: Statistical Yearbook of China 1994

The positive results reached during the 80's reinforce the reformist forces inside the CCP. The 14th Congress of the CCP in 1993 outline as major target of the process of reforms to build up a socialist-market economy and in 1993 the first Session of the Eighth National People's Congress amend article 15 of China's Constitution stating that "the state practices socialist market economy". In the same year the 3d Plenum of the 14th Central Committee approved a "resolution on the establishment of the socialist-market economy structure" where the party point out the need to give primacy to the social property and the overall combination of the different elements of the economy; to improve the system of corporation management focusing in the market needs and separating rights from property; to split up the role of the government from the direction of public companies; to create an unified an open global market assuring that rural and urban markets are integrated and interact with the world economy; to meliorate the regulatory functions of the government, giving special importance to the indirect controls over the direct; to perk up the system of wealth redistribution combining the requirements of equality, with selecting certain regions and groups of the population as core recipients and enlarging it, gradually, to the rest of the population; to advance economic development and keep social stability²⁴.

The year 1994 assist to numerous reforms in the global business environment in areas like finance, taxes, bank regulations, bonds, trade, prices, movement of goods and funds. The following year new measures were fulfilled to reform SOE's (state-owned enterprises) adapting them to updated managerial skills, opening them for restructure into small, medium and big enterprises and allowing the formation of conglomerates. In the period 1996-2000 six policy reforms were chosen as chief goals of the economic and company reform: to build up a modern managerial system inside public state companies, to improve efforts to coalesce regional and local markets reorienting them to the international markets; to regulate individual ownership of companies and shares, to improve labor regulation and create a system of welfare for workers; to advance state management of the economy through the use of macroeconomic controls; to expand the open-door policy; to develop the global legal environment assuring the necessary conditions for the operation of the socialist-market economy were met.

²⁴ Qin Shi, *China*, Editorial Nueva Estrella, Beijing, 1997, pp 96-7.

8. The open-door policy

The open-door policy aimed to be a strategic response to the necessity for overcoming the disparities in development between the various provincial and regional economies and their inherent imbalance in transport, infrastructure, resources and development opportunities. A policy was established to create several areas with distinct practical possibilities and necessities within the coastal zones, which would be more or less open to the outside world.

Since 1979, five *Special Economic Zones* (SEZs), Shenzhen, Zhuhai, Shantou, Xiamen and Hainan Island, have been established in Guangdong and Fujian provinces near Hong Kong, Macau and Taiwan, with the intention of attracting foreign direct investment (FDI), introducing advanced technology and new management techniques, creating new job opportunities and developing export-oriented industries²⁵.

A Special Economic Zone has four special characteristics: (1) administrative restrictions are relatively relaxed and concepts of a free market instilled at the expense of obedience to central planning directives; (2) fiscal incentives, i.e. tax reductions and exemptions, are offered; (3) the system of property ownership is mixed, with private property, especially emphasized, co-existing with quasi-private, cooperative, collective and "state capitalism"; (4) they are of large dimension and have sufficient autonomy to approve FDI inflows.

The SEZ's are laboratories in which new management techniques and economic policies can be tested before being adopted in the rest of China. They are, therefore, *filters* for isolating and expurgating those aspects of foreign technology and culture that are considered inappropriate for Chinese needs. They also act to smooth the process of reunification of Taiwan with Mainland China²⁶.

Between them, Shenzhen occupies the position of pioneer, both for the value of investments and the rate of development²⁷.

China today possesses, as a consequence of legislation on foreign capital joint ventures, a network of legal regulation to ease investment and investors into the various municipalities, as well as the SEZs²⁸.

With the important participation of Hong Kong, Macau and Taiwan in channeling investment in search of cheaper land rentals and labor costs, the SEZ's have had an influential role in the importation of machinery and equipment, in the improvement of management capacities and technical training of Chinese labor and in the attracting of foreign technology and its subsequent transference to other parts of the country.

Map 1 *China's golden coast*

²⁵ According to David K.Y. Chu in "China's Special Economic Zones: expectations and reality", *Asian Affairs*, 14, n°2, p.77-79.

²⁶ They act as dynamos for the reunification of Hong Kong and Macau with the Mainland during the second half of the 90's. After 1997 and 1999 the economic interactions between the two SARs and the two close SEZs deepen enormously as new policies like CEPA were designed in order to press them.

²⁷ Ai Wei in "The Special Economic Zones: an analytical study", *Issues & Studies*, 21, n° 6, p.117-35.

²⁸ The laws more precisely are: the "Law of the PRC on Chinese-foreign joint ventures", adopted on 1st July, 1979, at the second session of the Fifth National People's Congress, the "Law of the PRC on Chinese-foreign contractual joint ventures", adopted on 13th April, 1988, at the first session of the Seventh National People's Congress, and the "PRC Sino-foreign joint venture law", approved at the same session. These laws are published in the collection of PRC legislation, vol. 2, May 1988. Later, the "Sino-Foreign equity joint-venture terms tentative provisions" approved by the State Council on September 30, 1990, and by the "PRC, Sino-foreign venture Cooperative Joint Venture Law Implementing Rules", promulgated by the Ministry of Foreign Trade and Economic Cooperation, on September 4, 1995, and amended them.



Following the visit of Deng Xiao Ping to Shengzhen and Zhuhai²⁹ in April 1984, the State Council announced the opening of 14 coastal cities - Shanghai, Guangdong, the Pearl and Yangtze River deltas, the south Fujian triangle, the Shandong and Liaoning peninsulas - and Hainan Island to foreign investment³⁰.

Together these cities and regions form, in the shape of a crescent, a *belt of development* covering a coastal area of 320,000 km², comprising 292 municipalities and towns and a population of 200 million. At the heart of this extensive area is the Pearl River delta which has rapidly become the focal point of development in the south of China and a magnet for foreign investment, the setting-up of raw material processing industries and the production of semi-finished goods, chiefly textiles and knitwear. In 1995 the overall industrial outcome of this belt was of 1.591 trillion Yuan attracting also foreign investment estimated in 14.9 billion US dollars. The zone in Fujian, on the Chinese side of the Taiwan Strait, has constituted a fundamental center for trade with Taiwan and the funnel through which that country's heavy investment in China has been channelled³¹.

In addition to these regions, the frontier zones bordering the ex-USSR, Mongolia, North Korea, Pakistan, India, Nepal, Burma, Laos and Vietnam, covering 20,000 km², have seen a profound increase in development and have contributed to the improvement in the balance of trade between the western provinces and the center of China.

²⁹ Deng could have stated, according to some observers, that, "development and experience prove that policy of establishing SEZ's is correct". By 1994, the four SEZ's had surpassed the initial stages and already achieve notable progress in various areas.

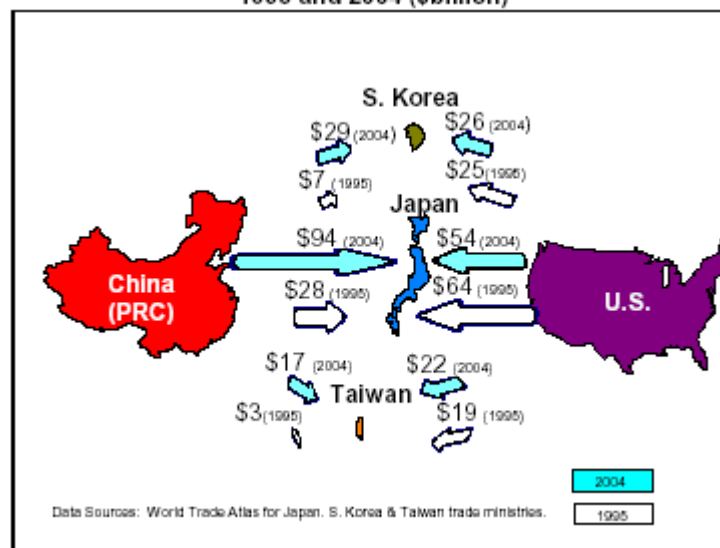
³⁰ For a fuller development of coastal city strategy, see Fuh-Wen Tzeng, "The political economy of China's coastal development strategy", *Asian Survey*, n^o3, March, 1991, p.270-284.

³¹ Those economic interactions suggest according to one observer, John M. Leger, in "Rags to riches-come together", *Far Eastern Economic Review*, October 12, 1995, that "what is taking place is the integration of China's coastal provinces, especially Guangdong and Fujian, into the economies of neighboring Hong Kong and Taiwan (...) Economically, anyway, the most dynamic regions of China look more like players in a regional trade zone and less like the rest of the mainland".

This strategy of developing both coastal areas and SEZs can be seen as the combination of a policy for growth, by encouraging imports, and economic expansion, by encouraging exports³² In 1990, the five SEZ's absorbed \$4.92 billion US dollars in foreign direct investment enabling the creation of more than 3000 joint ventures in electronics, light industry, textiles, food products, construction materials and machinery. These joint ventures produced goods totaling 28 billion RMB, \$4,6 billion most of which coming as revenue of exports and 60% as profits of the internal market. The SEZ's have the delegated power to authorize foreign investment up to 30 billion US dollars. Of the fourteen open coastal cities established in 1984, only Shanghai and Tianjin have the same privileges. The rest are limited to 5 million US dollars.

These zones participate strongly in the reorientation of Chinese trade to very lucrative markets (check the following map).

Figure 1
PRC and U.S. Exports to South Korea, Japan, and Taiwan 1995 and 2004 (\$billion)



Source: *The Rise of China and Its Effect on Taiwan, Japan, and South Korea: U.S. Policy Choices*, CRS Report for Congress, January 13, 2006, Ref. RL 32882

From the very beginning, a clear emphasis was put on strengthening trading relations first with the United States and then with Japan, Germany and other Western nations, breaking, once and for all, the traditional isolationist stance and the myth of self-sufficiency in national development that China had adopted.

The strategy of opening up to the world is firmly established with the renewal of Sino-US diplomatic relations and the visit of President Nixon to the mainland in 1972, followed by the recognition of the PRC by the US in December, 1978.

Official foreign relations are established between China and the European Community in May 1975, followed by the first trade agreement in April 1978.

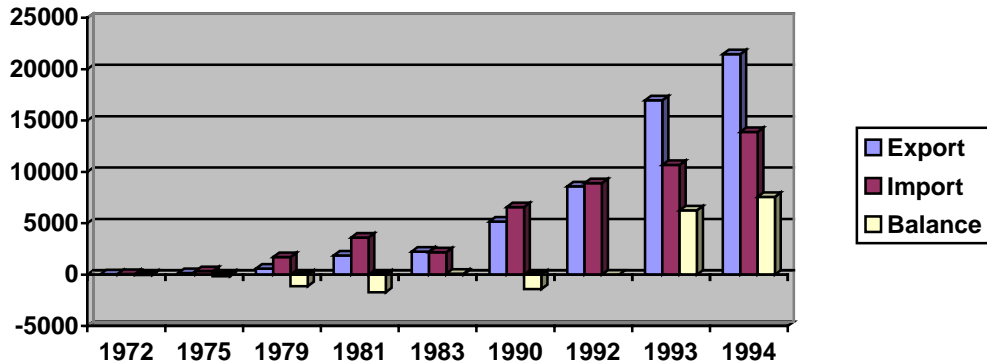
Following the normalization of relations with the West, the value of Sino-US trade soared from 92 million to 1,189 millions US dollars between 1977 and 1978 reaching a record total of 10 billion US dollars in 1988. Of the Chinese exports to the USA, the most significant were textiles and knitwear, petroleum and derivative products, pharmaceuticals, tinned food, furniture, antiques and art. The most noteworthy US

³² Jing-dong Yuan "Mainland China's Economic Zones: performance, problems and perspectives", *Issues & Studies*, March 1993, pp.80-105.

exports to China were machinery, transport and construction equipment, grain, chemicals, aluminum, paper and electrical material.

The role of Hong Kong in Sino-US trade has been the reason for confrontation in the analysis of the economic balance between the two countries, leading to conflicting opinions as to the exact size and nature of the current deficit. Chinese customs claim that the US has had a constant trade surplus with the PRC since 1980, while the US Department of Commerce states that there has been a deterioration in the balance of trade leading to a US deficit of 18,3 billion dollars in 1992, 22,7 billion in 1993 and 24,4 billion in 1994. The overall situation of bilateral trade between the two giants in the two decades following the re-establishment of political and diplomatic relations can be represented as following³³:

Chart I
Trade Balance China-US (million US dollars)



Source: China Customs Statistics 1994

³³ The issue of April 95 of *China Economic Review* point out that "the deficit with China is becoming an emotional issue but one that is clouded by a running dispute over "real" figures. The argument centers around the treatment of goods flowing via Hong Kong. Chinese goods shipped via the colony are counted by the US Department of Commerce as Chinese exports to the US; but US goods going to China via Hong Kong are counted as exports to Hong Kong".

Table II
Trade Balance China-US in figures (million US)

Year	Export	Import	Balance
1972	32	60	-28
1975	156	354	-148
1979	594	1.724	-1.130
1981	1.875	3.605	-1.728
1983	2.232	2.173	79
1990	5.179	6.588	-1.408
1992	8.593	8.900	0.306
1993	16.964	10.687	6.277
1994	21.461	13.893	7.567

Source: China Customs Statistics 1994

Notwithstanding the importance of Sino-US trade and the increase of the trade deficit favorable to China during the decades of 80 and 90 the trade relations between the two nations have been marked by an atmosphere of mistrust and bullying of reprisals over the annual renewal of Most-Favored Nation status for the PRC, a necessary provision for China goods entering competitively in the American market.

Japan, China's traditional strategic competitor and trade partner, has carried out the role of main supplier of equipment, technology and technical and financial assistance to the PRC. Accurately, the needs of the two countries complement each other. Japan is an essential market for Chinese exports of petroleum and its derivatives, coal, agricultural products and foodstuffs, antiques, art, etc. In exchange, Japan has supported China in the development of its export industries with a view to dominating the market for the provision of foreign currency, by placing lines of finance, at moderate levels of interest, at China's disposal.

Table III
Trade Balance China-Japan (million US)

Year	Exports	Imports	Balance
1972	491	608	-117
1975	1531	2258	-727
1970	2954	3698	-744
1983	5087	4912	175
1990	9011	7588	1423
1992	11678	13682	-2003
1994	21578	26326	-4748

Source: China Customs Statistics 1994 and Encyclopedia of New China

The reasons for Japan's investment and trade success with China are as much cultural as economic. The affinity which exists between the two countries on a cultural level permits the Japanese a deeper understanding of the psychology and way of life of the Chinese which thus facilitates the process of adapting products to the specific needs of the market; commercial marketing is done on a personal basis and *guanxi* is a very important factor in dealing with the Chinese state apparatus; Japanese products

are very competitively priced, Japan offers preferential rates under the GSP (Generalized System of Preferences) on investments loans; both countries are in close geographic proximity; Japan has, in helping China to develop its resources, strategically placed itself in a position to benefit from any foreign currency requirements that may be generated.

9. The macro-economic adjustments of the Eighth Five-Year Plan and the new miscarriages

In spite of the success of the open-door policy, consolidated during the 90s under the direction of Deng Xiao Ping, the regrettable events of June, 1989, and the repression of the pro-democracy student movement have left doubts within the international community as to the capacity and sincerity of China and its ruling elite to adhere to the concept of a *state of law* and faithfully follow international agreements and safeguard the common values held today by the international community.

After June 1989, Zhao was replaced as prime minister under the accusation of having succumbed to "bourgeois liberalization" and neglecting the "ideological and political work" of the Party. His replacement was Li Peng, a technocrat trained in the ex-Soviet Union and member of the Economic Reform Commission created by Deng that was one of the *orphans of the Revolution* taken beneath the protection of the Zhou (Enlai) family.

Contrary to the preceding authoritarian management of the economy under the sacrosanct "dictatorship" of rigid mandatory planning, the Eighth Five-Year Plan 1991-1995 and the Ten-Year Programme 1991-2000, had generated manifest, though praiseworthy, anxieties concerning decentralization and flexibility.

The state doesn't have any more the capacity to control the investments or the allocation of resources, neither generally nor locally. On this basis, the Eighth Five-Year Plan strategically aimed at the following: (1) the overall policies, objectives and direction of economic development; (2) the creation of measures to correct the actions of the market, i.e. a regulatory framework to prevent the formation of monopolies and barriers to trade while simultaneously promoting wealth distribution and job creation; (3) the fixing of objectives for the construction of infrastructure and for public sector investment.

Underlying the new macro-economic posture was a *plan of reform*, which prioritized *seven areas* and set out fixed structural principles³⁴.

These principles envisage the establishment of a new economic system centered on a "*planned commodity socialist economy*", that comprises planning with market regulation, planning as a function of macro-economic regulation and the market as responsible for the micro-economic allocation of resources. The *plan* was medium to long-term and aimed at driving the economy onto an aggregate level, with regard to policies, indirect economic controls, the balance between sectors and economic indicators. It also had a guiding function with regard "to vital products and construction projects for the national economy and for the standard of living of the population". The responsibility for managing the plan was committed to two entities: the *State Planning Commission*, which coordinated the macro-economic forecasts; the *Economic Commission*, which revised and control the achievements of the annual plans and coordinated the implementation of the economic reform.

The priorities for the reform were the following:

(1) *public sector enterprises*: the improvement of the system of contractual responsibility; the separation of taxes from profits on overall earnings; the gradual transformation of state enterprises into joint-stock companies; the merging of small

³⁴ See "*China: reform and the role of the plan in the 1990's*", BIRD/World Bank edition, Washington D.C., 1992.

businesses into large economic groups to ensure their financial solvency and, thereby introducing for the first time the possibility of bankruptcy;

(2) *the system of business property ownership*: the separation of ownership and management functions; the reconversion of state property and its decentralization onto sectorial and regional levels; the creation of holding and investment companies;

(3) *the system of price controls*: the gradual adjustment of prices to market levels, in accordance with the law of value, a small number of goods and services remaining, however, under administrative regulation;

(4) *macroeconomic management*: the institution of a system of macroeconomic regulation to balance a larger market economy and consolidate the activities of the coordinative organs of the state over the main systemic indicators;

(5) *the social security system*: the alteration of the philosophy of life-long employment, wage equalization and the role of the state as the *big pot* for a system based on individual business or sector based decision-making, with the state retaining the management of public sector service and enterprise workers, the responsibility for worker retirement and enterprises;

(6) *state intervention in foreign trade*: the abolition of export and company subsidies oriented towards foreign markets, and the promotion of horizontal mergers and partnerships with foreign companies;

(7) *agriculture*: the creation of a system combining both centralization and decentralization;

China's foreign trade flourished during the 90s and has been accompanied by a continued increase in the flow of foreign direct investment (FDI). Statistics confirmed the ability of the Chinese economy to continue to expand and the inflation to jump, causing alarm in the Chinese leadership, that press for anti-inflationary measures, allowing vital reorganizations of the productive infrastructure to be carried out.

10. The 1994-1996 outlook

A fiscal reform was enacted on January 1, 1994, with the introduction of a new value-added tax (VAT) with a unified rate of 17 percent. A tax on luxury goods and another on company profits, especially aimed at the secondary sector, complemented this new tax. New agreements between the central and provincial governments were settled with the intention of separating the management and collection of taxes at national and local levels³⁵.

In the monetary domain, China unified its dual exchange rate and domestic exporters were required to sell all their foreign exchange earnings to designated banks, which would then sell them on to the People's Bank of China (PBC). This significantly speeded up the PBC's accumulation of foreign exchange reserves, important for currency convertibility. The strong balance of payments has led to a rapid accumulation of foreign exchange reserves, which, noticeably, reached close to US \$ 70 billion by the end of September 1995.

In order to strengthen the process of marketisation of the macroeconomic instruments, the Central Bank has seen its powers reinforced governing the stability of the financial and monetary system. It was 100% owned by the central government, via Central Huijin Investment and National Council for Social Security Fund (SSF). It is the n Lee E. Preston stresses in "The managerial revolution in China", *Euro-Asia Business Review*, n^o 4, October, 1986, p.30, the post-1978 reforms consisted of three principal elements: (1) devolution of o.2 lender in China overall, the no.1 lender to non-

³⁵ This tax revenue-sharing aims to solve the problem of interest distribution between central and local governments and divide their tax revenues on the basis of rationally dividing their authority, according Feng Bing in "1994:soft landing of various reform measures", *Beijing Review*, December 26, 1994, p. 8-13.

institutions, and the no.1 foreign exchange lender. Aside from the PBC, four new banks have been created: the *Bank of China*, the *Industrial and Commercial Bank*, The *People's Construction Bank* and the *Agriculture Bank*. They were target to act as coordination units for the different operational banking areas they supervise³⁶.

The bank reform was completed with the approval of the *Central Banking Act*, already submitted to the National People's Congress (NPC) for discussion and approval, in early 1994.

The *state enterprise sector* has been the principal recipient of the structural reforms. In 1978, the public sector accounted for 78 percent of the industrial output of China. In 1993, this decreased 43 percent, not because of a drastic reduction of the state's presence in the economy, but because of the creation of a new entrepreneurial sector at the provincial level - the municipality companies - organized along several lines.

While still remaining the key to industrial growth in China, this sector represents one of the biggest *white elephants* on China move to efficiency and marketization. In 1993 the public sector account of 13,000 large companies (SOE's), employing in total 68 million people and were accumulating debts on loans to the banking sector estimate in 600 billion yuan³⁷. On June 1, 1994, a new Company Law was approved and it is expected to form the basis for the desired transformation of the SOE's.

The chronic insolvency of the SOE's continued during the rest of the decade and oblige the prime minister Zhu Rongji to implement a harsh restructure of the public sector at the beginning of 2000 that throw of thousands of workers to the unemployment³⁸.

Lee E. Preston enumerates in "The managerial revolution in China"³⁹, the three basic characteristics of these reforms: (1) devolution of decision-making powers from the central to the operational level; (2) increasing use of material incentives for workers and managers on a business level and in the productive process; (3) increasing use of market mechanisms based on rational pricing. And he adds:

The three elements are intimately related and all depend on the exploitation of management capabilities and innovation as well as the following of guidelines relative to production within the entire Chinese productive system. This takes for granted that management at primary levels of the productive process is capable of taking critical and at times risky decisions. One of the most commonly made observations by those who visit China concerns the fear and shock of low-level management with regard to determining production volumes, selecting or rejecting product modifications, researching the market and, ultimately, assuming the responsibility for their investment decisions

The reform of the company's ownership has not the automatic effect Chinese experts expect when the political authorities approved it. The Chinese SOE's needed to free from the protective umbrella of the state and operate in a market punish/reward

³⁶ Feng Bing, *ibid*.

³⁷ The official numbers revealed that in 1993, China had over 400.000 state-owned enterprises, with 71.600 subject to independent accounting, representing the industrial output value of all the the sector 53 percent of China's total industrial output value. See. Wu Naitao in "95 goals for reform of state-owned enterprises", *Beijing Review*, January 9, 1995.

³⁸ The reform of China's large state-owned enterprises has slowed this year as China's politicians try to head off social instability. High inflation, the poor performance of many state-owned enterprises, rising debt and growing unemployment is potential flashpoints that Beijing desperately wants to control during the leadership transition revealed the *Far Eastern Economic Review* in its edition of August 31, 1995.

³⁹ In *Euro-Asia Business Review*, n° 4, October, 1986, p.30

environment. The state must prevent itself from subsidizing them in order to assure that they can survive to their failures.

11. Jiang Zemin reigns over the process of reform

After Tiananmen, Deng Xiaoping retired from public life. While keeping ultimate control, power was passed onto the third generation of leadership led by Jiang Zemin. Economic growth, despite foreign trade embargoes, returned to a fast pace by the mid-1990s. Jiang's macroeconomic reforms furthered Deng's vision for "Socialism with Chinese Characteristics" but saw a continued rise in social corruption in all areas of life. Unemployment skyrocketed as unprofitable SOE's were closed to make way for more competitive ventures, internally and abroad. The ill-equipped social welfare system was put on a serious test. Jiang also laid heavy emphasis on scientific and technological advancement in areas such as space exploration. To sustain vast human consumption, the Three Gorges Dam was built, attracting supporters and widespread criticism.

The 1990s saw two foreign colonies, Hong Kong (Britain) in 1997, and Macao (Portugal) in 1999, returned to Chinese sovereignty. Hong Kong and Macao continued a great degree of autonomy, retaining independence in their economic systems. Conversely, Premier Zhu Rongji's economic policies held China's economy strong during the Asian Financial Crisis. Economic growth averaged at 8% annually, pushed back in 1998 by the great Yangtze floods. After a decade of talks, China was finally admitted into the World Trade Organization. Standards of living improved significantly, although a wide urban-rural wealth gap was opened, as China saw the reappearance of the middle class. Wealth disparity between East and the Western hinterlands continued to widen by the day, prompting government programs to "develop the West", taking on such ambitious projects such as the Qinghai-Tibet Railway. The burden of education was greater than ever. Rampant corruption continued despite Premier Zhu's anti-corruption campaign that executed many officials.

At the opening of the Fourth Session of the Ninth National People's Congress (NPC) the *premier* Zhu Rongji submitted an outline of the 10th Five-Year Plan for national Economic and Social Development (2001-5) that made a broadly positive balance sheet of the achievements and failures of the economic stride⁴⁰.

China's GDP increased by an average annual rate of 8.3 per cent and reach 8.9404 trillion Yuan (US\$1.081 trillion) in 2000. The target of quadrupling the 1980 per capita GNP (set by Deng in its Four Modernization Plan) was met ahead of time. State revenue reached 1.338 trillion Yuan en 2000 with an average annual growth of 16.5 percent. Zhu said that significant advances were made in the establishment of a modern corporate structure in large and medium-sized State-owned enterprises and key enterprises became corporations, some of them listed on stock market outside China. Zhu revealed that significant reduction of losses was achieved and the value of the shares held by the State in the industrial sector reached 239.2 billion yuan, almost the triple of the 1997 figure. The State macroregulation system was strengthened; information technology and new and high-tech industries grew rapidly.

The total volume of China's imports and exports reached US\$474.3 billion in 2000, with exports accounting for US\$249.2 billion, which represents a rise of 69 percent and 67 percent respectively over the 1995 figures.

More than US\$289.4 billion in foreign funds were used in the five-years period an increase of 79.6 percent over the period of 1991-5. China's foreign exchange reserves reached US\$165.6 billion in the end of 2000, US\$92 billion more than at the end of

⁴⁰ *China Daily*, "Nation drafts five-year blueprint",
<http://app1.chinadaily.com.cn/chinagate/focus/relief/news/i001/20010306rint.html>

1995. The living standards of the population improved reaching the per capita income of rural dwellers and urban residents respectively US\$272 and US\$759, increasing 4.7 and 5.7 annually in real terms. Zhu considered also that the objectives of the previous seven-year plan to free people from poverty were achieved as 80 million people get up the poverty line.

Zhu defined five guiding principles for the new five-year plan: making development the central theme; concentrating on economic restructuring; making reform, opening-up and technological progress the driving forces for economic growth; making improvements to people's living standards the prime goal; and co-ordinating economic development with social development. On the second target (sound economic growth) Zhu set the target for the average annual economic growth rate for the five years period at around 7 percent, 1.3 percent lower than the previous Plan. On the relations with the outside world the *premier* listed the need to pursue reforms, open China wider and "break down institutional obstacles to the development of productive forces". Referring to the target of raising people's living standards Zhu emphasized the need to "create more jobs, increase personal income, distribute income more equitably, improve the social security system and ensure a more comfortable life for the people".

In the industrial sector Zhu elected four priorities: first increase product variety, improve product quality, save energy, reduce waist, prevent and control pollution, and increase productivity; second speed up the development of key technology that can stimulate structural advancement by deepening up domestic innovation and imported technology; third, encourage the establishment of a number of large companies and enterprise groups through stock listings, mergers, associations and reorganizations; fourth, support and promote renovation of old industrial bases. Zhu mentioned that "the country needs to take economic, legal and necessary administrative measures to continue closing down plants and mines that produce shoddy goods, waste resources, cause serious pollution or operate under unsafe conditions".

Concerning the relation between State and state companies Zhu drop out three ideas: first, the need to encourage SOE's to adopt a share-holding system and to change their operational mechanism by listing on the stock market, setting up joint ventures with foreign investors or holding each other's shares; second, State must hold a controlling stake in strategic enterprises that concern the national economy and national security, but not necessarily 'others'; three, the functions of the government needed to be transformed to reduce administrative oversight and approval. Zhu urged further reform of the management systems of industries under State monopoly, such as electricity, railways, civil aviation and telecommunications.

China became member of the World Trade Organization in 2001, ending a very difficult process of negotiation and assuming a set of obligations that will conduct to the removal of restrictions to the access of foreign goods and services.

In 2002 at a press conference at the closing of the Fifth Session of the Ninth National People's Congress⁴¹, Zhu reflected on the four years period since he was elected *premier*, saying that the promises have been "basically fulfilled" and that was satisfied with the rapid development of the Chinese economy, which achieved a growth rate of 7.8 per cent in 1998, slightly below a targeted 8 per cent. Zhu was, nevertheless, cautious on the improvements in agriculture referring that an oversupply of agricultural products has led to cheap market prices, which resulted in slow income increases for farmers. With China's accession to the World Trade Organization (WTO), farm products from the United States will flow into China on a large scale, which will cause even more difficulties for farmers, he pointed out.

⁴¹ *China Daily*, March 16, 2002 in <http://app1.chinadaily.com.cn/chinagate/focus/relief/news/i001/20020316zhu.html>

On the financial side, Zhu alleged that China's fiscal deficit and government debt have been controlled being below internationally accepted warning levels and that China's budget deficit reached 309.8 billion yuan (US\$37.46 billion) in 2002, accounting for 3 per cent of the gross domestic product (GDP), and the treasury bounds the two sides will hold a series of events to celebrate the occasion, Zhu said. Asked to comment on corruption cases revealed in some branches of Bank of China, Zhu said "individual cases" will not have a negative impact on the credit of the bank and its goal of becoming listed overseas.

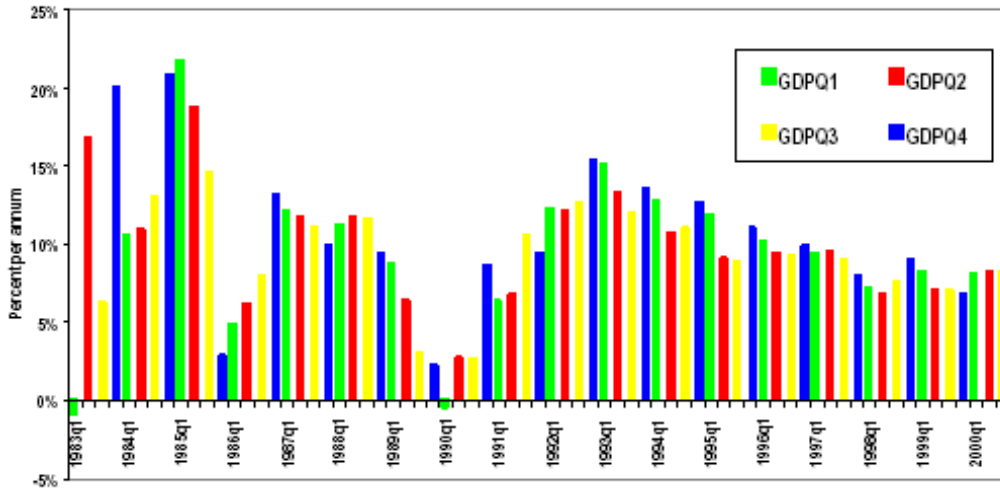
In the five years period that conclude the century two uncertainties have cleared themselves up. The first was the central government's commitment to create a market economy, tied to the world at large. The reason seems somehow elusive: the Communist Party can see its legitimacy disappear unless it can deliver growth and keep the path of development in a clear and visible rhythm. Zhu Rongji, by temperament and training, an engineer has his reforming way and made it clear since the beginning: new sources of growth have to be found by drastically shrinking the state. The first two decades of the reform have been catch-up growth, gains that came from disbanding the agricultural communes and from allowing capital and labour be poured into low-end manufacturing and processing, mainly for export destination.

The government has hardly to foster growth creating new jobs for workers that were lay-off from unproductive state-own enterprises, migrants from the countryside and young people looking for the first job. These high-growth rates have gone and laying the foundations for the next phase of growth was much harder, as higher productivity in agriculture becomes at a price of people leaving the land for urban areas for whom jobs need to be found. These trends feed the forecast of a prolonged industrial slump and a social crisis at the beginning of 2000 that recommend to Chinese leaders to craft serious structural change and market reforms, that although painful, would lay the foundations for long-term, growth and for party's long-term, survival⁴². By doing that China would clean the state sector easing the runway to membership of the WTO. This help to solve a second uncertainty, which is whether China can bring about a smooth and successful change to an open economy under a political system that remains highly authoritarian. Commentators seem mostly divided on this issue, favoring liberals that the integration of China with the world economy will increase the pressure on China becoming more open, liberal and receptive, forcing profound changes on its political and its society.

Looking at statistics the performance of Chinese economy in the so said period was steadily and positive. Lawrence J. Lau, of Stanford University, portrayed it like this in November 2000:

Chart III Quarterly Rates of Growth of Real GDP

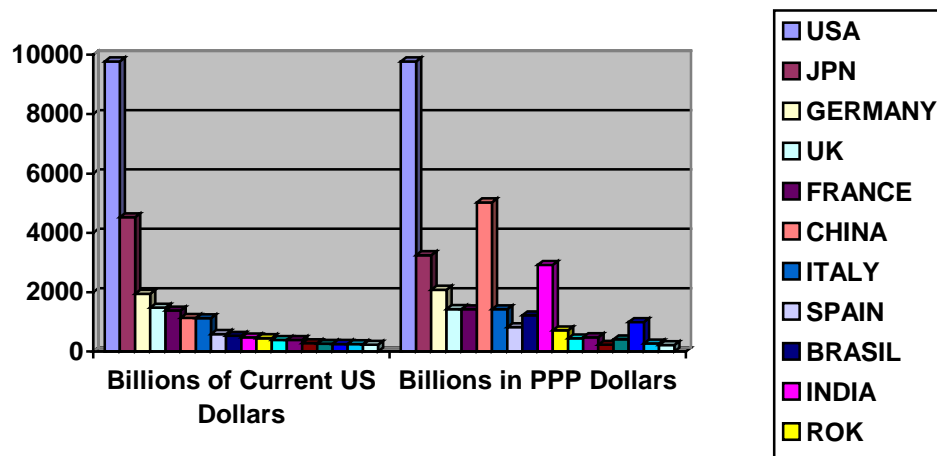
⁴² *The Economist*, "Now comes the hard part", April 8, 2000.



Source: <http://www.stanford.edu/~ljlau/Presentations/Presentations/111500.PDF>

What comments can we advance to it? Basically that although China's economy had not reach the levels of performance achieved in 1993 and 1994 ($\Delta 15\%$) her GDP experienced levels of growth over 7 percent, which were outstanding in comparative terms. Steve Chan presents it accordingly with World's Bank Development Indicators ⁴³.

Chart IV
Comparative GDP's, 2001



China appears in the tabel as the world's sixth largest economy just placing itself ahead of Italy, being the U.S. economy 8.6 times larger. China attained second place (after the U.S.) if its economy is adjusted for purchasing power parity (PPP). Comparing the 2000 GDP per capita (adjusted for PPP) of the 12 countries included in the compilation China appears next to the lowest and just over India (US, 35,619; Japan, 25,924; UK, 24,252, Germany, 23,917; France, 23,614; Italy, 22,876; South Korea, 14,937; Russia, 9,996; Brazil, 7,745; Indonesia, 4,035; China 3,844, India, 2,684) what documents the gap that she has to overcome in order that her population may enjoy the levels of comfort and progress China leaders have promised for ages

⁴³ Steve Chan, "Is there a power transition between the US and China?" in *Asian Survey*, Col. XLV, n.o 5, Sept/October 2005, p. 699.

Summarizing somehow what's been said, beginning in 1979, China launched several economic reforms. The central government initiated price and ownership incentives for farmers, which enabled them to sell a portion of their crops on the free market. In addition, the government established four special economic zones along the coast for the purpose of attracting foreign investment, boosting exports, and importing high technology products into China. Additional reforms, which followed in stages, sought to decentralize economic policymaking in several sectors, especially trade.

Economic control of various enterprises was given to provincial and local governments, which were generally allowed to operate and compete on free market principles, rather than under the direction and guidance of state planning. Additional coastal regions and cities were designated as open cities and development zones, which allowed them to experiment with free market reforms and to offer tax and trade incentives to attract foreign investment. In addition, state price controls on a wide range of products were gradually eliminated.

Since the introduction of economic reforms, China's economy has grown substantially faster than during the pre-reform period. In January 2006, China made major revisions to its GDP data for 1993-2004. The revisions indicated that, based on new estimates of growth in the service sector, the size of China's economy and its GDP growth was significantly higher than previously estimated. For example, real GDP growth in 2004 had been originally measured at 9.5%, but the revised figure puts this rate at 10.1%. Overall, the size of the economy in 2004 was estimated to be nearly 17% higher than previously thought. Based on these revisions,

China's average annual real GDP is estimated to have grown by 9.6% between 1979 and 2005; it grew at 9.8% in 2005 (see Table IV).

Table IV
China's Average Annual Real GDP Growth Rates, 1960-2005

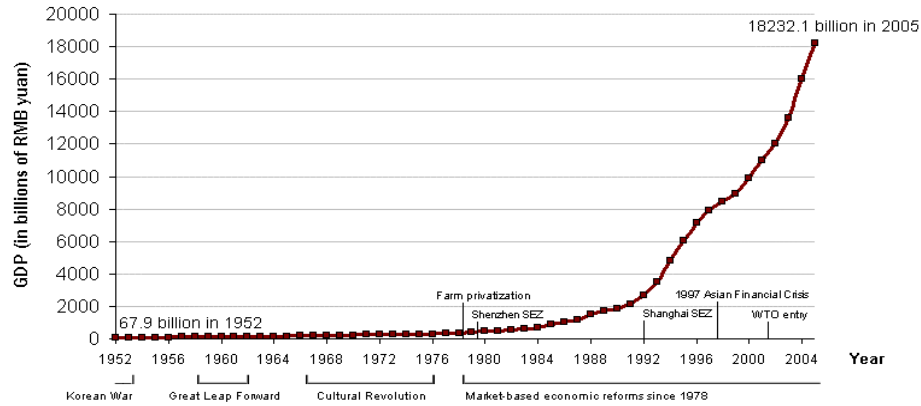
Time period	Average annual % growth
1960-1978 (pre-reform)	5.3
1979-2005 (post-reform)	9.7
1990	3.8
1991	9.3
1992	14.2
1993	13.1
1995	10.9
1996	10.0
1997	9.3
1998	7.8
1999	7.6
2000	8.4
2001	8.3
2002	9.1
2003	10,0
2004	10,1
2005	9.8

Source: Official Chinese government data.

Now in figurative terms:

Chart V

People's Republic of China's Nominal Gross Domestic Product (GDP) Between 1952 to 2005



Source: Wikipedia, [http://en.wikipedia.org/wiki/People's Republic of China](http://en.wikipedia.org/wiki/People's_Republic_of_China)

Analysts generally attribute much of China's rapid economic growth to two main factors: large-scale capital investment (financed by large domestic savings and foreign investment) and rapid productivity growth. These two factors appear to have gone together hand in hand. Economic reforms led to higher efficiency in the economy, which boosted output and increased resources for additional investment in the economy. Economic reforms, which included the decentralization of economic production, led to substantial growth in Chinese household savings (these now account for half of Chinese domestic savings). As a result, savings as a percentage of GDP has steadily risen; it reached 49% in 2004, among the highest savings rates in the world.

China's decentralization of the economy led to the rise of non-state enterprises, which are inclined to pursue more productive activities than the centrally controlled SOEs. Additionally, a greater share of the economy (mainly the export sector) was uncovered to competitive forces. Local and provincial governments were allowed to establish and activate various enterprises on market principles, without interference from the central government. In addition, foreign direct investment (FDI) in China brought with it new technology and processes that boosted efficiency.

China's trade and investment reforms and incentives led to a surge in foreign direct investment (FDI), which has been a major source of China's capital growth. Annual utilized FDI in China grew from \$636 million in 1983 to \$61 billion in 2004, and \$58 billion in 2005. The cumulative level of FDI in China stood at about \$618 billion at the end of 2005. Analysts predict that FDI will continue to pour into China as investment barriers are reduced under China's WTO commitments and Chinese demand for imports continues to increase. Considering FDI for the 1979-2004 period about 43% of FDI in China came from Hong Kong. The United States is the second-largest overall investor in China, accounting for 8.5% (\$48.0 billion) of total FDI, followed by Japan (\$46.8 billion), Taiwan (\$39.6 billion), and the British Virgin Islands (\$36.9 billion) and South Korea (\$25.9 billion).

Table V

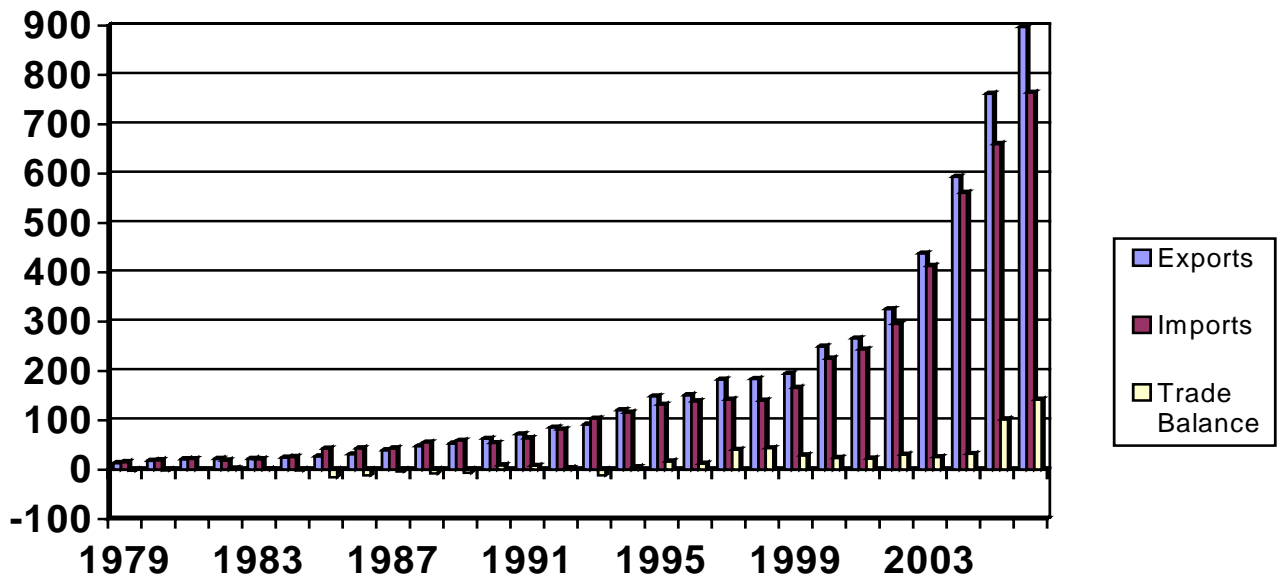
Major Foreign Investors in China (countries)

Country	Cumulative Utilized FDI: 1979-2004		Utilized FDI in 2004	
	Amount (\$Billions)	% of Total	Amount (\$ Billions)	% of Total
Total	563.8	100.0	64.0	100.0
Hong Kong	241.6	42.9	19.0	29.7
United States	48.0	8.5	3.9	6.1
Japan	46.8	8.3	5.5	8.6
Taiwan	39.6	7.0	3.1	4.8
British Virgin Islands	36.9	6.5	6.7	10.5
South Korea	25.9	4.6	6.2	9.7

Source: Chinese government statistics

Economic reforms have transferred China into a major trade powerhouse. Chinese exports rose from \$14 billion in 1979 to \$762 billion in 2005, while imports over this period grew from \$16 billion to \$660 billion. In 2004, China surpassed Japan as the world's third-largest trading economy (after the United States and Germany). China's trade continues to grow dramatically: From 2002 to 2005, the size of China's exports and imports more than doubled. In 2005, exports and imports rose by 28.4% and 17.6%, respectively. China's trade surplus, which totaled \$32 billion in 2004, tripled \$102 billion. At the end of 1005, the PRC became the fourth largest economy in the world by exchange rate and the second largest in the world after the United States purchasing power parity at US\$8.158 trillion. The GDP per person reach US\$1,700.

Chart V
China's Merchandise World Trade



Source: International Monetary Fund, Direction of Trade Statistics and official Chinese statistics

Merchandise trade surpluses, large-scale foreign investment, and its peg to the U.S. dollar have enabled China to accumulate the world's second largest foreign exchange (after Japan). China's accumulation of foreign exchange reserves has been particularly acute over the past few years. China's total reserves reached \$820.6 billion at the end of 2005, up nearly 40% over 2004.

On July 21, 2005, the People's Bank of China announced that it would move to a floating peg, allowing its currency to move against the U.S. dollar by 0.3% a day, and 3% against other currencies. Many American companies have difficulty exporting to China due to U.S. federal restrictions and China's handling of its currency, which exacerbated the trade gap between the PRC and the U.S..

China is attempting to harmonize the system of taxes and duties that imposes on companies, domestic and foreign and for that reason preferential taxes and duty policies that benefit exporters in special economic zones, coastal cities and other "open" zones have been targeted for revision. There is a large disparity between coastal regions and inner and central China, To counter this problem and the social distress that it implies the Chinese government has implemented the China Western Development Strategy Initiative (2003) and a Central China Policy (2004) which are aimed to help the rural populations to overcome their externality towards China's frenetic path of development.

12. The 11th Five-Year Plan (2006-10) pave the way to an "harmonious Society"

The new leadership headed by Hu Jintao (President of Republic) and Wen Jiabao (*premier*) is uneasy by the impact that this gap of wealth has created in the people's mind, favored the myth of a coastal El Dorado that spread like an hurricane following Deng and Jiang appraisal of the capitalist bubble. Capitalism means in any context that some (few) win and get rich and the majority doesn't win so much, comparatively.

The annual session of the National People's Congress (NPC) held in March 2006 echoed this unrest as Chinese leaders haven't avoid the question if is not now the time for China to moderate its path of development and growth, turning its national income redistribution policy more fair, equitable and socially just. After all the maoist revolution - 50 years ago - had an unmistakable social message of justice and fairness, for all.

The discussion of the 11th Five-Year Plan (2006-10) marked a shift away from the traditional *extensive growth mode* almost exclusively geared to GDP increase, to another approach more focused in development and orientated towards balanced and harmonious growth.

On March 5, 2006, *premier* Wen Jiabao said⁴⁴ in the opening of the inaugural session of NPC that accelerating the re-alignment of the economic structure and promoting the transformation of economic growth mode was one of the overriding tasks during the Plan period, considering that the problems springing up in the course of China's economic development lies in irrational economic structure and in the extensive growth mode. For that reason high-tech industries, manufacturing and energy sectors need to enjoy priority in the following five years as information, financial, insurance, logistics and tourist sectors have to be promoted. "Over a fairly long period of time, the country's economic advances have been achieved at the expense of the environment" he said. The 11th Five-Year Plan feature a number of projects regarding a cyclic economy, ecological-system protection and pollution

⁴⁴ See http://www.chinadaily.com.cn/english/doc/2006-03/14/content_535327.htm

treatment have already been planned in order to raise energy-use efficiency and stave off environmental deterioration.

In terms of economic performance during the 10th Five-Year Plan period (2001-06), China's GDP registered an average 9.5 per-cent growth each year. The total GDP volume of 2005 hit 18,232 billion yuan (US\$2,257 billion), ranking the country fourth among the world countries. Revenue reached the 3,000 billion yuan (US\$369.9 billion) mark and foreign exchange reserves exceeded US\$800 billion. But this explosion came at a certain price according with the *premier*: "at the same time, however, disproportionately large amounts of energy were consumed and environmental pollution worsened. Also, innovative power of the nation remained weak, which explains why the core technologies of many Chinese products are patented in foreign countries"

Wen Jiabao quoted impressive data:

- The per head arable land in China is only 40 per cent of the world average and this figure is likely to slide further in the scenario of quickened pace of urbanization and further demographic increase
- Fresh-water resources are a quarter of the world's average level, a situation compounded by uneven distribution. As a result, more than 400 Chinese cities have deficient water supplies, 110 seriously so
- China's per capita shares of petroleum, natural gas and coal are respectively 11 per cent, 4.5 per cent and 79 per cent of the world average. As a result, the country is becoming increasingly dependent on overseas resources. In 2005, China imported 136 million tons of oil, with the total consumption standing at 317 million tons
- A total of 48.2 billion tons of industrial waste and domestic sewage, for example, were discharged in 2004. In the same year, China's carbon dioxide emissions were second only to the United States
- The assessment of the world countries' sustainable environment indices, which was issued by the World Economic Forum in Davos, 2005, placed China 133rd among 144 countries and regions
- 3.56 million square kilometers of land are suffering from soil erosion, accounting for 37 per cent of the China's territory. About 1.74 million square kilometers of land have suffered desertification, and more is threatened. Overgrazing has given rise to serious grassland degeneration

Going through the causes of the situation Wen honestly referred that although switching the extensive growth mode to intensive one has long been urged since the reform and opening up the outdated mode dies hard. Governments at various levels still enjoy excessive power over resource distribution, and exhibit strong investments. Many localities rush to expand their economic size and go in for high-energy, high-pollution industrial projects. Second, resource prices are in many cases distorted, failing to reflect the real value, as many types of resources are still priced by the state, operating on the inertia of the old planned economy. Third, monopoly still reigns in some sectors, being profits for the monopolies taken for granted no matter whether the product quality is good or not. Fourth, performance of local governments has long been gauged quantitatively by output values and economic growth rate to the neglect of energy consumption and the environment. Qualitative measurement of economic growth has been largely ignored. Fifth, laws and rules covering intellectual property rights protection have remained incomplete and the institutional climate for innovation is bad. In sum, the extensive growth mode must be immediately shifted to an intensive one, something the 11th Five-Year Plan has set the stage for⁴⁵.

⁴⁵ *Intensive growth mode has extensive benefits*
http://www.chinadaily.com.cn/chinagate/doc/2006-03/21/content_548261.htm

The document fixed as targets reaching US\$3.2 trillion for the GDP in 2010 and increasing the GDP per capita to US\$2,400, compared with US\$1,700 in 2005.

Outside commentators were more cautious considering the promises included in the Five-Year Plan. Willy Wo-Lap Lam, Senior Fellow at The Jamestown Foundation and Hong Kong-based journalist and analyst considered that there are relatively few doubters regarding the achievement of the announced goals, but more ambitious objectives such as curtailing pollution and energy waste—and in particular, “constructing a harmonious society”— remain illusory given the CCP refusal to entertain comprehensive structural and political reforms⁴⁶:

More reforms are needed to achieve the FYP’s economic and social objectives. Despite China’s accession to the World Trade Organization in 2001, the party and state still control a disproportionately large chunk of the economy namely 170 aircraft-carrier companies, which include the major oil, steel, telecommunications, transport, and financial firms and institutions. Private entrepreneurs, who should be at the forefront of innovation in both industry and the services, are often unable to compete with companies that have sterling party or government connections.

Willy Wo-Lap Lam concluded that the 11th FYP has been singularly disappointing as either structural reform of the government or political liberalization is concerned. The Hu-Wen team underscored the imperative of “boosting party leadership” in ideological, cultural, and media fields, including the need to “uphold the correct guidance of public opinion” in accordance with Marxist and other orthodox values.

The Hoover Institution was more optimistic, reading in China's new 11th Five Year Plan “‘remarkable’ proposals, both for what they contain, and for how they were created. The proposals set few quantitative targets and no specific industrial policies or programs. Instead, they present a program for government action designed to ensure that rapid growth will be sustainable over the long term, and that the fruits of growth will be more equitably shared. The recommendations are broad and abstract, and in many cases specific policies needed to implement the recommendations do not exist. Both the Plan and the manner in which it was drawn up are highly characteristic of the Hu Jintao-Wen Jiabao administration. As such, the plan should be seen as this administration's economic program”⁴⁶.

The new FYP documented the new vision of Hu Jintao-Wen Jiabao leadership. The concept of “harmonious society” (*hexie shehui*) proclaimed by Hu Jintao implies a combination of high growth with social justice. It is intended to chase three objectives: 1) transforming the old type of growth that has an emphasis solely on GDP to a new one that enshrines balanced development; 2) reduce income disparities that exploded sensitively in the last years; 3) to target scientific development.

Hu Jintao “vision” is a departure from Mao’s vision of a “good society” centred onto an “egalitarian society”. A society that grasp several characteristics from the Leninist doctrine of State: nationalization of all economic activities; prioritisation of a planned economy; political and social control under the short-hand of the Party; a class-absent society; socialism with trademark poverty; the creation of a “new class” formed by bureaucrats and party officials that monopolized political economy.

Deng Xiao Ping defended in the 70’s a different vision of society, a “comfortable society” (*xiaokang shehui*) based in seven comprehensible features: 1) poverty is not a part of socialism; 2) “let some people and some regions get rich”; 3) “development is

⁴⁶ “China's 11th five-year plan A roadmap for China's "harmonious society?" in <http://www.asianresearch.org/articles/2756.html>

⁴⁶ “The New Common Economic Program: China's 11th Five Year Plan and What It Means ” in <http://www.hoover.org/publications/clm/issues/2898936.html>

the hard principle" after the Soviet Union and the East Europe have fallen; 4) economic reform and transition to a market economy is the chosen path; 5) economy needs decentralization, social and local incentives need to be created in order to facilitate it; 6) "open-door policy" –let the barbarians come in and bring with them foreign capital; 7) maintain the basic political control but allow some freedom to the society; 8) elect "common prosperity" as the goal. Jiang Zemin vision was derived from Deng's and add three additional characteristics: to modernize the ruling party opening it to private entrepreneurs; amend the Constitution providing legal protection for private property rights; the "three represents" (*san ga dai biao*). The Party must always *represent* the requirements of the development of China's advanced productive forces (businessmen), the orientation of the development of China's advanced culture (national utilities), and the fundamental interests of the overwhelming majority of the people in China (democracy?).

What does Hu Jintao envisage with the new social policy beneath the "harmonious society" complex? To shift dramatically the old grown model (Deng's) by making the performance of national and local governments accountable to the opinions and aspirations of local communities (govern to the people, looking at the people and satisfying the needs of the people); guaranteeing a "common prosperity" (not likely some will get rich but the rich will get less rich in order the "poorest" get less poor); redirecting the investments (not exclusively to the eastern coastal cities) but to the northeast and central backward China; revise the income tax from 800 yuan to 1,600 yuan extending the group of people who will pay for the poor; draft new policies to cope with urban unemployment.

The Chinese political establishment has long been keenly interested in developments in Eastern Europe. From the start of reform, China looked to other communist and transition societies not only to scenarios to emulate but also for scenarios to avoid⁴⁷. Chinese leaders set up –at earlier stages of reform – an *Economic Reform Investigation Group*, that looked to East European models like Romanian, Hungary and Yugoslavia, countries that have experienced their own unique systems of socialism and whose standards of living are presumed to be higher than other socialist countries. The Ceausescu's execution in December let Deng Xiaoping and other Politburo members to gather and watch videotapes of the execution and the insurrection of the people against the party. Somebody argued at the end of the viewing "we'll be like this if we don't strengthen our proletarian dictatorship and repress the reactionaries". To which Deng replied "yes, we'll be like this, if we don't carry out reforms and bring about benefits to the people"⁴⁷. This is really the point behind China's systematic reforms and drifts of direction: to avoid the collapse of the regime (as happened in the Soviet Union) and the disintegration of the country (as occurred with Yugoslavia) winning its legitimacy by satisfying the people's requests. But the problem that contemporary western liberal-democratic societies are confronted with, subsists. How to avoid that the expectations and requirements of the people guide them to claim a limited government, a government that rules by consent?

13. The ideological combine below the pragmatic approach

The preceding analysis reveals, therefore, a trend in the course of the development of the Chinese planned socialist economy towards a socialist-market economy, i.e, capitalism. But this itinerary is far from unanimous (and from ending).

Although the increase of the role of the market during the last decades acted as a regulator for the allocation of goods one's must bear in mind that the state continues

⁴⁷ Christopher Marsh & Nikolas K. Gvosdev, "China's Yugoslav Nightmare", *National Interest*, Washington, n.o 84, Summer 2006, p. 103.

⁴⁷ Cited by Benjamin Yang in *Deng: a political biography*, Armonk, NY; M.E. Sharpe, 1998.

to have an almost omnipresent role in all aspects of economic life, throughout administrative regulation and direction, macro-coordination of state enterprises and fixing some market price.

It is undeniable that the concept of "socialism with Chinese characteristics" enshrined in China's Constitution has adapted traditional Marxist thinking to a Chinese reality while at the same time adopting elements of capitalism and free-market economics. The criterion, according to some, for the description of the course of the Chinese political process is to be found, therefore, in discovering how decisions relative to production and distribution are taken and by whom and, in second place, who is in possession of what.

It's necessary at this point to leave, briefly, the main analysis in order to add an important note. In the modern world, the forces and relations of production are integrated into a system of interconnected and interdependent markets and decisions of economic management depend more on exogenous and circumstantial restrictions than on the decisions of national governments. We can conclude from this that no economic system remains static or functions in a vacuum. The forces for change are an integral part of economic activity, and this activity is related to social classes, economic interests, the localization of power and the ideological framework, or *beliefs system*.

And if, as Marx stated and what is today openly accepted in social sciences, industrial capitalism is the manifestation of the inner forces of social conflict - such as those of development and the natural environment, poverty, freedom and the accumulation of capital and technological change - then it is also the position between people, i.e. those who acquire wealth and influence and those who don't, which generates phenomena of inter-class exploitation and subsequent demands for liberation.

If socialism claims to be a social system free from internal conflicts and inter-class exploitation and the liberator of the forces of production, then the examples that history has given us, don't allow us to verify it. Which therefore leads the definition of the exact nature of the Chinese *model* towards the internationally dominant model - capitalism- in the field of conceptualization and ideology.

The public ownership of the means of production seems to be the only criterion by which to distinguish *socialist relations* of production from *capitalist* relations. Capitalism is based on the general recognition of the private ownership of the means of production and on the predominance of the market as the regulator of economic activity. Socialism is based on the substitution of private property for the socialist or collective property of the workers and on the role of the state in consolidating the dominance of this form of property ownership and as the motor of social and economic development.

According to socialist thought, a socialist economy doesn't demand the total elimination of private property. Some contemporary socialist thinkers state that family and individual production should remain in private hands and only the big enterprises with large workforces should be placed in public ownership, i.e. nationalized, as, according to Marx, they determine the *nature of society* and consequently the actions of the people. On the other hand, classical socialist thought states that the economy must be organized on the basis of a *central authority*, which defines objectives, establishes plans, creates an incentives system for achieving its objectives and supervises their attainment while at the same time allocating resources and distributing income.

This was the model that guided the bureaucratic planning of the USSR and the geo-political block of nations, which came under its influence, with well-known results. However, as national economies become more *open* and therefore more *conditioned* by outside forces, whatever the political system, it becomes necessary for them to adjust

to the mechanisms and functioning of the market and to review the guiding role of planning, restricting it to decisions concerning large-scale investments or development, allowing themselves to be submitted to private control and market regulation. This is what has been termed by political scientists as *market socialism*.

Despite the bankruptcy of Leninism as a system, witnessed by the collapse of the USSR and Communist East Europe, the social-democrat experience in several European countries make feasible a system that combines welfare, equality of opportunities, democratic participation and public oriented controls of wealth accumulation through taxation, free markets, financial markets, private property of enterprises or shares.

At the same time, the development of a sort of a *post-capitalist society* has led to substantial changes in class structures and adulterate the typical Marxist contradiction: working class *versus* capitalist class. New economic and social groups have emerged, such as State bureaucracy, intellectual workers, managers, and other experts that don't match the Marxist ultra-simplification.

These groups represent new social realities in former socialist states and are part of an important and influent middle-class that looks to have a major role in the selection of policies and in the redistribution of national income.

How can the role of the Party as the central, unifying force over sectarian and regional rivalries be replaced, avoiding the return to an authoritarian and self-reliable centralism, centered in the planning *pafernalia*?

Perhaps the answer is to be found in the theoretical model of *market socialism*.

13. The market socialism paradigm

Daniel Fusfeld⁴⁵ describes this new political reality as using self-determining markets to set the pattern of production and the allocation of resources while retaining certain elements of socialism, such as the collective ownership of the means of production and the model of equity for the distribution of income.

The use of market mechanisms permits the economy to respond with flexibility to consumer demand and guarantees wider freedom of choice. At the same time, the central government keeps control of macro-economic policy to determine the necessary level of investment to ensure full employment and a comfortable rate of economic growth. The collective ownership of the means of production and distribution by central government, cooperatives and worker's associations eliminates private control of resources and permits a pattern of wealth distribution based almost exclusively on profits from earnings.

The author believes it will be necessary to establish a national central planning commission to determine the following:

- the level of aggregation of economic activities and the rate of economic growth and fiscal and monetary policy;
- the prices of all products, worker's salaries and the rates of return on capital.

In the author's opinion, this model has clear advantages: (1) the capacity to lessen income disparities by way of a more equal system of distribution although it is accepted that differences in salaries will exist according to the type of work done, i.e. shop floor or management; (2) the drawing of the economy towards more competitive market forces, once the role of the central planning commission in controlling prices, limiting the rise of national monopolies and centralizing of information fundamental to the taking of decisions by economic agents is established; (3) the decentralization of the decision-making process to the point where only overall prices are fixed and

⁴⁵ Daniel Fusfeld, *Principles of Political Economy*, Scott, Foresman and Company, Boston, 1988, p.743.

controlled by the central planners and other decisions are taken at company and buyer level.

Other writers⁴⁶ in their search for a definition of this model have added to the freedom to own property and the maintenance of a planning structure for the framework and level of investment, the introduction of multiparty and participatory democracy as the ultimate factor in the decision-making process of distributive politics and the ultimate demand of a model of market socialism.

China has followed the path, apparently without setback, towards market economics and away from mandatory and bureaucratic central planning. As Deng on his visit to the south of China in February, 1992, stated:

capitalism and socialism don't have a direct connection to an economy which is planned; a planned economy and a market economy are both economic measures. The real nature of socialism is to free the productive forces and the ultimate objective of it is to achieve prosperity for all

The essence of the model of Chinese socialism will not be found so much in the combination of central planning with market regulation and/or the enormity of the public sector relative to the emerging private sector, but in the primacy given to the role of the Party in conducting social, political and economic life, in correcting disparities in growth and imbalances between the cities and the countryside and in taking hold of the expansionist impulses of the regions more exposed to western capitalism and those too fragile to be absorbed by this model of development⁴⁷.

Perhaps it is because of this, that some see the success of the open-door policy as being rooted in the contradictory nature of Chinese economics⁴⁸, i.e. the indispensable factor of central political direction for maintaining national unity combined with the growing predominance of market regulation over productive forces.

14. Three scenarios for a political (but not necessarily democratic) transition

Considering the above analysis, one would be tempted to put into perspective three different scenarios for China's political and economical transition in the next decades.

Different evaluation of the forces in conflict within Chinese society will dictate the preferable course. As China's recent history reveals, these decisions (and eventual

⁴⁶ See John Roemer, "The possibility of market socialism" in *The idea of democracy*, Cambridge, Cambridge University Press, 1992; P. Bardhan *Risk taking, capital markets and socialism*, Berkeley, University of California, 1991; S. Estrin and J. Le Grand, *Market Socialism*, Oxford Clarendon Press, 1989.

⁴⁷ This doesn't mean, as Jan S. Prybyla, *ibid* defends, that from the point of view of the coherence and the internal consistency of the system it isn't fundamental that one or another form of coordination and ownership is dominant so long as the mechanisms and structure of each have no contradictory effect on the principal economic indicators. This author believes, however, that a mere arithmetical consideration of the specific weight of each one of the model's vectors as a means of characterizing the system as capitalist or socialist is erroneous. It is according to my opinion, the agglutinative action of the CCP, as the political center, which defines the originality of the system.

⁴⁸ Dwight Perkins notes in *"The Market Mechanism and Economic Reforms in China"*, Armonk, New York, M.E. Sharpe, 1991, p.22-23, four conditions that must be met for a market system to work well in a reforming centrally planned economy: (1) goods must be made available through the market rather than through administrative allocation; (2) prices must reflect long-run relative scarcities rather than dictates of the plan; (3) competition must exist; no monopolists, otherwise no productivity gains; and (4) managers must behave according to the rules of the market, rather than those of the state bureaucracy.

reorientation) will result from a process of debate, elaboration, hierarchization of objectives that will foster the consensus achieved, rather from the pressure or exogenous forces.

a) The reinstatement of capitalism

China's route to socialism was, from the beginning, a lonely march and after 1949 a March against the Soviet leadership of the communist movement and its expansion throughout the Third World, namely the Southeast Asia Region.

However, the collapse of the Soviet Union in 1989, and Eastern Europe subsequent democratic conversion has turn difficult for other socialist planned-economies to continue to exist. Preserving a sort of socialist economy is either than a political problem, a problem of obsolescence in managing a modern economy considering the interdisciplinary challenges of the 21st century.

This is the first circumstantial factor that pushes China towards capitalism or a more unequivocal market economy. The Five-Year Plan for instance has no real significant role in modern economies has the allocation role of resources and needs to be cleared up by the markets, domestic and international. The segmentation of policies and priorities - what we call in the West macro-economic policies - are made public by the program of the government or during the annual approval of the state budget. That's the way happen in societies with inquisitive public opinions.

Immanuel Wallerstein, the political economist, usually states there is an expanding capitalist world-economy that occupies the space of international relations and conditions, restricting to the same extent the national policies of the countries concerned. This world-economy has become during the 90s and the first six years of the 21st Century obvious and omnipresent in any corner of the globe. This is something China is not in position to avoid (namely after becoming member of the WTO).

The open-door policy has generated, in China's population and economic elite, a frenetic appetite for consumption and enjoyment. It would be tough to dissuade, China's inhabitants that China is now pulling back to maoist frugality and scarcity.

China's South has been, since the 80s, positively *contaminated* by the influence of foreign (or capitalist) *enclaves* of Hong Kong, Macau, and Taiwan. That proximity allow a process of learning and economic empowerment that per passed to the special economic zones located in the other side of the border (Zhuhai and Shengzhen) and in Fujian province. The impressive success of these free-market areas has induced new attitudes and a thirst of consumism. It ameliorates, in a short number of years, the living standards of the population. A phenomenon that came to stay, for at least for more 50 years.

The continuation in power of a communist leadership has created, in the former Soviet Union, (as in China) a class of *aparatchicks* that are expected to struggle to maintain their position and extend their privileges. The seclusion of this small class makes the balance of the system a nightmare, as people become more conscious that they have a *say* in the political process.

These two factors are seeds of a civil society consciousness and an excuse for social change.

In opposition to these trends, there are four counter-factors that would help to balance a more or less organized attempt to abandon socialism.

The Chinese Communist Party is now the oldest communist leadership in the world and is struggling for survival in very difficult conditions. The *survival factor* shall weight and lead to a deeper revitalization of the political system and, in ideological

terms, a drift of the Communist Party to become (probably with other name) the central nationalist force in China's 21st Century society⁴⁹.

Secondly, the Party elite still controls the chief institutions in Chinese society and the heart of economic institutions. The leadership will try, because of China's size and its large population, to preserve the predominance of public and social interests over the "private sector" in order to provide *the daily bowl of rice for every Chinese person*⁵⁰. This is a psychological factor that is deeply embedded in Chinese mind and an emblem of pride and patriotic fervor that the communist leadership has successfully instilled in each Chinese. The *moto* is socialism and allegiance to China and the Communist Party will make China even stronger in world eyes.

Thirdly, the dimension of political rightness in the implementation of the reform process touches the expectations of the inland population and revindicates the role of a central power and a quasi-authoritative center for maintaining the balance between the impoverished north and the wealthy south and coastal/inland disparities. This dimension of social redistribution of wealth and income would constitute a barrier to any attempt to move towards capitalism and the parceling of China.

Fourthly, the abandonment of socialism is clearly seen by the majority of the Han population as a way to divide China, to break it in pieces; an invitation to the greed of neighbors and major world powers. The belief in Chinese unity in a Harmonious Society (*hexie shehui*) has been emphasized by Chinese leadership as the new core of a Chinese *renaissance*.

These four factors strongly circumvolve any temptation that the liberal forces could have, inside or outside China, to break with the current socialist course.

b) The return to an authoritative planned economy model

The second scenario may be setback of the reform process and the open-door policy and the return to economic sovietism.

Recent factors give some mass to this scenario.

First, there are signs of a mounting revolt in inland regions of China against the reforms and the ability of the central government to ensure a more equitable redistribution of the income generated in the south. A extensive economic crisis has spread in rural areas as farmers migrate to cities and coastal areas looking for better jobs, leaving agricultural tasks behind them and deserting the fields. Political unrest in rural areas against the police and party authorities are now common. The exasperation of this phenomenon may lead to a sort of setback.

Second, the old ideological guard has return and complains on the course of the revolution and the abandon of political rightness. These people are increasingly criticizing Deng Xiao Ping by the failures of the process and demand the communist leadership to *close ranks*, guarantying the survival of the Party and of its legacy.

Third, the tumultuous relations between China and the United States could deteriorate if the American president persists in *containing* China in the international arena, and made its support to Taiwan quest to independence to obvious. China normally reacts irritably when major powers intent to internationalize Taiwan issue, and like a chased animal would be tempted to react vigorously if the pressure is to much.

Nevertheless, five counter-factors may prevent this scenario from occurring.

⁴⁹ We assist to this in countries of the Eastern Europe where former communist parties change name to socialist party (or social-democrat) and won the pools in open, democratic and clean elections.

⁵⁰ That's why Jiang Zemin open the ranks of the Communist Party to entrepreneurs and "capitalist roaders". It's better to have them inside and close to the core of the leadership then out and free riders.

First, the Chinese economy is becoming even more internationalized and interdependent as a result of the restructuring of the economy and the efficiency gains it achieved that have contributed to a more than tenfold increase in GDP since 1978. The *external debt outstanding* amounted, in 2004⁵¹, to US\$228.8 billion, i.e. 11.8 percent of GDP. If China closes itself to the outside again, how can it remain competitive and satisfy its international obligations?

Second, China has restricted its ambitions to become a superpower in the next century, apparently fulfilling itself to be a leading regional power ahead of Japan, South Korea, Indonesia, Thailand and Malaysia. But needs to strengthen its international reputation in order that can be respected as such (regional) power. This could be damaged by a setback in the reform process and opening to the outside.

Third, the aim of the Fourth Generation headed by Hu Jintao is to achieve reunification of all Chinese territory. After resuming the sovereignty of Hong Kong and Macau, Taiwan became the last and decisive task. China has given formal guarantees that will extend the capitalist system preserved in Hong Kong and Macao to Taiwan if Taiwanese people decide to rejoin the motherland. Chen Shui-bian, Taiwan present president and head of the Democratic Progressive Party (DPP) has traditionally been supportive of Taiwan independence, and haven't made things easy for China to regain Taiwan sovereignty. He is finishing its second term and a return of Kuomintang to power becomes likely as a reaction to Chen stressing relation to Beijing. China return to harsh socialism will make things difficult domestically and internationally.

Fourth, the current pace in the process of reform has induced a higher level of professionalism in enterprises enhancing the ability of corporate managers, and staff to act as agents of transformation and use the market as a sensor of economic performance. This is an attitude that is difficult to invert.

Fifth, Guangdong province has become China's gateway to the world for more than three decades now. China's economic integration with other regional economies have been achieved and fortified through Guangdong, and the region as acted as a dynamo for foreign investment.

Considering all the positive and negative factors, a return to a soviet-type planned economy is mostly unanticipated.

c) The consolidation of China's market socialism

The official title for China's economic model is a *market commodity socialist economy*, being its continuation the most probable outcome of China's meeting with the next future. For five basic reasons that I will address now.

First, a market-socialist economy is a political conception that fruitfully combines the strengths of both capitalism and socialism in a developing country: planning's concern for instrumental coordination and the predominance of public ownership over private; the initiative and creativity of the market in generating wealth and development and positioning the economic agents as protagonists of economic relations and motors of the economy; the state's coordination of planning according to the principle of commodity exchange and *the law of value*, gradually shifting to use mainly indirect means to control enterprises.

Second, market socialism assures continuous *feed-back* on economic measures and policies, allowing assessment of the social impact of different policies, regionally and nationally, giving the central government the inputs that consent rectification.

Third, market socialism preserves the pivotal role of the state in Chinese economy, maintaining the public sector predominance and controlling the balance with the private sector, and the relative position of foreign interests (article 6 of the

⁵¹ The total external debt evolution was 170.1 billion \$US (2001), 168.3 (2002), 193.3 (2003) according with Chinese statistics.

Constitution states "the basis of the socialist economic system of the People's Republic of China is socialist public ownership of the means of productivity, namely, ownership by the whole people and collective ownership by the working people").

There are, however, some problems related to the strengthening of the proposed scenario.

In one hand, market socialism is an economic system based on initiative and decentralization and the gradual removal of state intervention from the economy. This trend will led to question the *monolithic character of the political system*, raising the issue of furthering the participation of commoners in the decision process.

The CCP has favored a very stumpy level of participation in the selection of local and regional officials and imposed the majority consensus over a free debate of ideas and dissent. The bureaucratic system of *multi-party cooperation under the leadership of the CCP* is a mystification and will not resist demands for democratic reform of the political system.

How long is that reform to be delayed is something that could endanger the stabilization of the model.

On the other hand, there are always difficulties in integrating planning system with market economics, i.e. in maintaining a rough balance between total demand and total supply. Each side of the chain tries to impose its rules to the other: the state pressing the creation of big utilities, the consumer demanding better quality and a wider choice of commodities.

The most important question underlying the problem is until what point is the central government prepared to decentralize state's powers and allow local governments to manage their resources, collect their taxes from consumers and company, and reinvest them locally, with minimal central income arrogation from the central government?

In other words, is China prepared to evolve a federal or a more decentralized political system⁵² without breaking into pieces?

Finally, the process of China's admittance to the World Trade Organization and its economic integration in the South China's Sea Region will clearly favor the speeding up of "market" reforms and China's interlock with neighbor economies. How can China's economy even more competitive, open and internationalized without getting rid of the remaining socialist inputs?

Nevertheless, I'm tempted to recognize that the socialist-market economy model has a role in solidifying China's path to secure a major position in the Southeast Asia Region and worldwide.

At least, because it would give time to China's elite to prepare the political reforms the country is aiming for so long.

15. Final conclusion

Preserving the legitimacy of the leaders that drove into power after Mao has pass away, Deng Xiao Ping sowed the roots for China becoming a normal country and the fast developing economy in the world. China achieved 12 percent of the world economy on purchasing parity power in 2004 (just after the United States) and has contributed one-third of global economic growth in the same year. Its foreign exchange reserves are the seconds in the world with \$700 billion US dollars (after Japan).

And even if we can still identify, in China's economic (and political) path, several factors of unrest, it would be irresponsible to close the eyes to what has been achieved

⁵² For a fuller forecast of China's political and constitutional scenarios see my article "A paradigm of autonomy: The Hong Kong and Macau SARs", *Contemporary Southeast Asia Revue*, Institute of Southeast Asian Studies, vol. 18, n°1, 1996, Singapore.

in thirty years: between 1981-2001 poverty felt in China by 422 million people (China is still home to 18 percent of the world's poor; Chinese rural areas still have over 26 million people living in absolute poverty).

We must, therefore, prevent from categorizing these factors along with the patterns of previous experiences but try to assess Chinese course to socialism, whatever he means, nowadays, as something really new and noteworthy. The heralds of the new pos-cold war era have failed in foreseeing the end of ideologies and the end of history as an inevitable outcome for socialist countries that resist the forth wave of democratization in Russia and Eastern Europe. The course of nations is not so simple as that.

The *socialist market economy* path could be a response of developing countries to the challenges of competition and an interdependent free world economy. The critic problem seems to be of social justice. How governments can prevent income disparities to extend to a point that they can led to national fragmentation and turmoil? How can the leadership avert the social unrests to undermine political stability and legitimacy?

Of course it is also unrealistic not to consider the lack of democratic participation and leadership accountability as symptoms of political backwardness. As in other areas of the developing world, the problem of economic (and sustainable) development cannot be regarded as something isolated or a feud for economists and planners but rather as a problem that needs a global range considering its interactions with social policies and the equilibrium within the political sphere.