

Session I

Can China Maintain Domestic Stability? What Will Be Its Likely Behavior in the Future?

China's Economy Today and the Challenges It Faces in Shifting to Capitalism

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1. Introduction

Ever since China began focusing on domestic reforms and open door policies at the end of the 1970s, it has been achieving an annual average growth rate as high as 9.7%. This growth is not the result of China strictly adhering to the principles of socialism, but conversely because the country has abandoned such principles. It is no exaggeration to say that, as reflected by the growth of private companies and the progress made in privatizing state-owned companies, China has already reached a stage where "it is no longer socialist."

The Chinese government officially describes China's economy today as being in "the primary stage of socialism." Since both proletariat and bourgeoisie have been created at the same time, the economy comes closer to the early stage of capitalism; that is, "the stage of primitive capitalism." There is no doubt that the country's goal is not an advanced stage of socialism, but a mature (or advanced) stage of capitalism.

In fact, the "overall moderately prosperous society" set by the Chinese government as the target of economic development is common to a mature form of capitalism in that it presupposes not only a market economy and private ownership, but also the rule of law instead of rule of men, democracy rather than dictatorship, and systems for correcting the disparities between rich and poor through a redistribution of income. Neglecting to build such institutions might cause China to fall into the trap of crony capitalism.

If China shifts from one-party dictatorship by the Communist Party to a more democratic political system, unification with Taiwan will become a reality. Moreover, by using its advantage as a latecomer, the country is projected to continue enjoying higher growth than advanced countries for a prolonged period to come. Considering the strong likelihood of the yuan (renminbi) rising in value in the future against major currencies in line with the rising international competitiveness of Chinese products (just like the yen since the 1970s), China is likely to replace the USA as the world's biggest economic power before 2050 in terms of gross domestic product (GDP).

2. From socialism to capitalism

In 1978, the Third Plenary Session of the 11th Central Committee of the Chinese Communist Party proposed efforts toward modernization by introducing reforms and open door policies under the leadership of Deng Xiaoping. Since then, more than a quarter of a century has passed. In the meantime, China has maintained its socialist cover, while pushing forward with capitalism. As reflected by the fact that private companies have assumed a leading economic role in place of state-owned companies, the economic realities have increasingly drifted farther away from the authentic principles of socialism. To justify the Communist Party's one-party rule, new interpretations have been invented to match the circumstances of the times and whenever a new direction for reform was drawn up. Judging from the segmentation of its people into bourgeoisie and proletariat, China should be understood as being not in "the primary stage of socialism" but in "the stage of primitive capitalism."

(1) Whither Socialism?

Traditional socialism is based on the three pillars of "income distribution in accordance with labor," "resource allocation based on planning" and "public ownership centering on state-owned enterprises." This runs counter to the characteristics of capitalism, which are "income distribution in accordance with production factors such as capital," "resource allocation based on market principles" and "private ownership." Unlike Russia, China did not opt to undertake shock therapy and shift to capitalism in a short period of time, but rather decided to take the path of gradual reform, switching the three pillars of socialism with those of capitalism one by one. First, between 1978 and 1992, the government implemented reforms that redistributed authority and profits to lower-level governments and companies. From 1993, it embarked on the introduction of the market mechanism, and the country has now entered the stage of ownership reforms centering upon privatization.

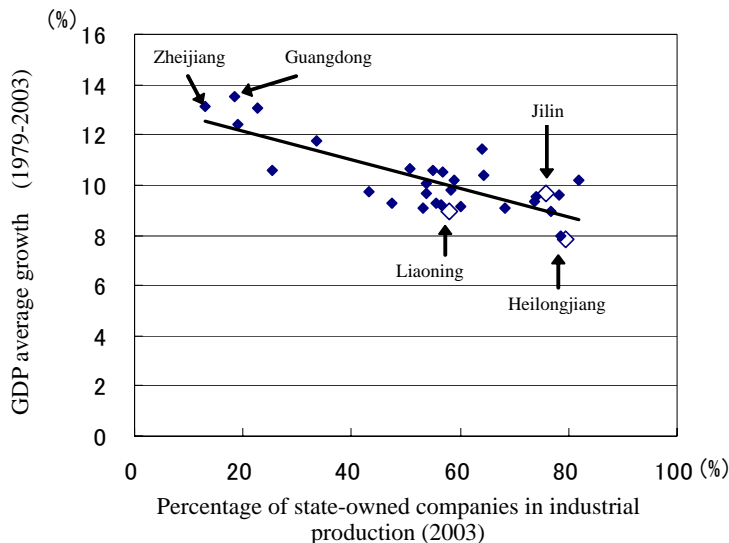
During the first stage of reforms between 1978 and 1992, the principle of income distribution in accordance with labor was gradually abandoned. In the agricultural sector, people's communes were disbanded and a contract system based on household units was introduced. Meanwhile, on the industrial front, authorities began to condone the pursuit of profit. The Chinese economy was invigorated as each economic entity began to pursue profit for its own sake. However, at this stage, state-owned enterprises and economic planning were still the leading players of the Chinese economy, and market forces, not to mention private ownership of property, were only tolerated as necessary evils.

After Deng Xiaoping's speech during his tour of southern China in 1992, the formation

of socialist market economics was designated as a national goal at the 14th National Congress of the Chinese Communist Party held in the same year. Under a market-oriented environment, privately-owned firms grew rapidly, but many state-owned enterprises became unable to bear the intensifying competition, and their operations are continuing to slide. The problem of nonperforming loans at state-owned banks which extended loans to these firms was also worsening.

The low efficiency of state-owned companies is common to all countries, and China is no exception. In fact, since the reforms and open door policies were instituted, economic growth tends to be lower in regions having a higher share of state-owned companies (see Figure 1). For instance, the three Northeastern Provinces (of Heilongjiang, Jilin, and Liaoning) have higher shares of state-owned companies than other regions, and thus fall short of the national average in terms of economic growth. In contrast, Guangdong province (home to many foreign-owned enterprises) and Zhejiang province (where private companies are becoming active) are the fastest growing provinces in China.

Fig. 1 Growth in GDP of selected provinces in inverse proportion to the percentage of state-owned companies



Source: Compiled based on respective year editions of the Chinese Statistics Yearbook

As it became clear that the red ink at state-owned enterprises and the nonperforming loans would in the end become a burden on government finances and that private companies were far better than state-owned enterprises in terms of productivity and earnings, the

authorities could not help but condone privatization. The privatization process that began with small and medium-sized firms spread to large companies under the principle of “the strategic realignment of the state-owned economy” presented at the 15th Party Congress of 1997. In order to accelerate privatization, under the “Decision on Issues Regarding the Improvement of the Socialist Market Economic System” adopted at the Third Plenary Session of the 16th Central Committee in October 2003, it was decided that public ownership through a shareholding system should take the place of state-owned enterprises as the mainstay of the economy. “Shareholding” in this sense signifies a mixed ownership that absorbs state-owned capital, collective capital and private capital. Depending on the circumstances, the role of state-owned capital in these shareholding firms may take the form of absolute shareholding or relative shareholding. As a result of this breaking away from traditional ideology, we are likely to see more capital participation in state-owned enterprises by foreign companies and private companies.

While the “Decision” still maintains the wording “keeping public ownership as the mainstay of the economy,” by expanding the definition of public ownership, the leaders have kept the pretext of socialism intact while embracing the substance of capitalism. Depending on interpretation, the shareholding system, which has been given the status of main form of public ownership, can include purely private firms such as the publicly-listed companies in capitalist countries. If the traditional definition is followed, it is not an exaggeration to say that China is no longer in a stage of socialism. However, under the new definition, one could even go so far as to say that not only China but capitalist countries such as the United States and Japan are also socialist nations that maintain “public ownership as the mainstay” of their economies.

As if to signify the spread of capitalism, China now consists of various classes. “A Study Report on the Strata of Chinese Society Today” compiled by the Institute of Sociology of the Chinese Academy of Social Sciences (edited by Lu Xueyi, Social Sciences Literature Publishing, 2002) covered a series of analyses conducted based on the ownership status of “organizational resources (political resources), economic resources, and cultural resources,” and concluded that Chinese society consists of ten social strata and five social rankings. The ten social strata are classified as: (1) state and social leaders (2.1% of the total), (2) high and middle corporate executives (1.5%), (3) private entrepreneurs (0.6%), (4) technical professionals (5.1%), (5) clerical workers (4.8%), (6) private business owners (4.2%), (7) tertiary industry workers (12.0%), (8) industrial workers (22.6%), (9) farmers (44.0%), and (10) unemployed or partially employed people (3.1%). The five social rankings are referred to as the top, medium top, medium middle, medium lower, and bottom layers. The social ranking of industrial workers and farmer is classified as the medium lower layer, below that of

private entrepreneurs and corporate executives.

(2) Not so much in “the primary stage of socialism” as in “the stage of primitive capitalism”

Unlike the former Soviet Union and East European countries, China has not totally denied its conventional socialist ideology. Rather, it has been revising it step by step. As a great step in that effort, the country presented the “theory of the primary stage of socialism” at the beginning of the 1980s. Secretary General Zhao Ziyang systematically elaborated on the theory at the 13th Party Congress of 1987. This “primary stage” is said to last at least a century. This allows socialism to be shelved as an “ideal” system for the distant future on one hand, and justifies the introduction of capitalistic elements on the other.

According to Marxist ideology, a country shifting to socialism must have achieved a certain degree of industrialization, with its productivity already high. However, neither Russia nor China had experienced the stage of being an advanced industrial society, and had to pursue socialism while having very low productivity. When instituting reforms and open door policies, Chinese leaders looked back on the policies implemented during the three decades from 1949 to 1978 and changed their thinking to first raising productivity to a high level before seeking “a full-fledged socialism” worthy of being called an advanced stage of socialism. At that time, their basic idea was to increase productivity not through a conventionally planned economy, but by introducing capitalistic elements. Based on that idea, China introduced a “socialist market economy” that allows for private ownership.

Socialism was originally a set of ideas intended to create an equitable society based on public ownership of the means of production. However, the realities in China show that the fruits of economic development are concentrated among a limited number of people, and are therefore increasingly far away from the goal of an equitable society. Such a situation is not indicative of the primary stage of socialism, but something similar to primitive capitalism—a process of creating a relationship between capital and wage-based labor necessary for establishing capitalism. Coastal regions, in particular, are undergoing industrialization based on the “exploitation” of migrant workers from inland areas and a boom for housing construction resulting from the virtual privatization and concentration of land (land enclosure). These are scenes that evoke England back in the early days of capitalism.

(3) The path to crony capitalism to be avoided

In China, which is in the midst of its transition from a planned economy to a market economy, excessive government involvement in the allocation of economic resources and business activities is creating a hotbed for corruption. Needless to say, considerable resources were controlled by the state even during the planned economy era. Back then,

however, the market was almost nonexistent in China, acts of corruption hardly went beyond small sums of money for some sort of favor. As marketization proceeds, the opportunities for high-ranking government officials to abuse public power for private gain have sharply increased.

In particular, the “gradual reform” that accommodates a two-tier structure (so-called dual-track system), with the coexistence of planned and market economy, state- and non-state-owned enterprises over a long period, has created an environment prone to corruption. For instance, in the 1980s, state-owned enterprises flocked to make quick and easy money by procuring materials at a cheap “planned prices” and reselling them for more in the free market. Even today, such “arbitrage activities” are frequently carried out under the initiative of local governments as far as land transactions are concerned. Likewise, in the privatization process of small and medium-sized state-owned enterprises from the 1990s onward, managers have taken advantage of their positions to acquire ownership of these enterprises at an extremely low cost through management buyout or other means.

The state of corruption in China has been revealed primarily in the form of media coverage of specific incidents uncovered. However, it is widely recognized that reported incidents are but the “tip of an iceberg.” Cheng Ming, a Hong Kong-based monthly magazine, reported in its August 2006 issue that the whole picture of the iceberg, which may be described as “crony capitalism,” has been revealed in a joint investigation by various Chinese authorities, including the research office of the State Council, research office of the Central Communist School of China, research office of the Chinese Communist Party’s central public relations department, and the Chinese Academy of Social Sciences. According to the report, China has a total of 3,220 multimillionaires with personal assets (excluding those held outside China) exceeding 100 million yuan (about ¥1.5 billion), of which some 90%, or 2,932, are family members of high-ranking Communist Party or government officials. It also says that in the highly regulated business fields such as finance, external trade, land development, major projects, and securities, most key corporate positions are occupied by such family members.

It is clearly evident that officials of the Chinese Communist Party—who are supposed to be the vanguard of the proletariat—and their relatives engaged in business are making a fortune by using their authority as backup in actively putting into practice Deng Xiaoping’s theory of allowing some people to get rich first before others. This collaboration among relatives is mockingly called “One Family, Two Systems” as a parody on “One Country, Two Systems” (describing a unified China where a capitalistic system exists separately in Hong Kong from the socialistic system in mainland China). While corruption has become the most important means of “primitive capital accumulation” in China, a “class of bureaucratic

capitalists” linked with the powers that be has been formed, resulting in a rapid concentration of income and wealth.

The Chinese Communist Party and the government, on the other hand, launched efforts to eliminate corruption and ensure a “clean” government as early as the 1980s, and have recently been stepping up public relations, training, and cracking down on corruption. Even so, such efforts are nothing but a “symptomatic treatment.” Corruption cannot be countered unless eliminated at the root. Under the rule of law and in a democratic system, forces act to curtail governmental power. However, such an environment has yet to be realized in a country predominantly ruled by a one-party dictatorship. To avoid the path to “crony capitalism,” one must begin with political reforms.

3. Toward a mature form of capitalism

Given that China has entered “the stage of primitive capitalism” as opposed to the “primary stage of socialism,” the country should clearly seek to realize a mature form of capitalism instead of an advanced stage of socialism. Here, a mature form of capitalism presupposes not only a market economy and private ownership, but also institutional arrangements to correct the disparities between rich and poor through a redistribution of income, along with the rule of law and democratization. China must revise its conventional strategy based solely on enhancing efficiency and pay closer attention to fairness, while at the same time speeding up political reforms.

(1) An overall moderately prosperous society that stresses fairness

To overcome the evils brought about by misguided egalitarianism during the era of the planned economy, Deng Xiaoping promoted reforms and open door policies that put efficiency before equality under the slogan of allowing some people to get rich first before others. Now more than a quarter of a century later, the living standards of the people have generally improved, but the distribution of income has become increasingly unequal. In addition to the conventional axis of conflict between “rural areas” and “cities,” and between “east” and “west,” a new axis of conflict has recently been added: the widening gap between “rich” and “poor.” The increasing unfairness of Chinese society is becoming a factor that may threaten social stability and its sustainable development. To achieve stable and sustainable growth by correcting the disparities between rich and poor, the Chinese government has presented a strategy targeting an “overall moderately prosperous society.”

During the early days of reforms and open door policies, Deng Xiaoping had already made a “moderately prosperous society” the goal of China’s modernization. What Deng

Xiaoping assumed as a “moderately prosperous society” was an intermediate stage between a minimum standard of living at which clothing and food could be secured on one hand, with a well-off life on the other. A moderately prosperous society, or *xiaokang*, was initially a social ideal put forward by ancient Chinese thinkers, and in the *Li Yun* of the *Li Ki*, or *Book of Rites* compiled in the Earlier Han Period, it was described as being the second-best society after *datong* (or *utopia*). In a *datong* society, public ownership was supposed to be the norm; in contrast, *xiaokang* was depicted as a society in which people had self-interests, and that it needed to be governed through rites, or institutions, just like in a capitalistic society.

The new goal of “overall moderate prosperity,” as stipulated in the Report of the 16th Party Congress held in 2002, aims to extend “moderate prosperity” throughout the Chinese society by accelerating the development of the middle, western, and rural regions.

With the emergence Hu Jintao and Wen Jiabao as new leaders to head the government, greater emphasis has come to be placed on an “overall moderately prosperous society” being a “harmonious society.” To achieve this goal, a “scientific concept of development” intended “to develop the entire society in a sustainable and balanced manner with the people put first” was proposed as a guideline. More specifically, the guideline consists of “five harmonies:” (1) harmony in development between cities and rural areas (emphasizing rural development and addressing the issues of farmers), (2) harmony in regional development (supporting underdeveloped regions), (3) harmony in development between the economy and society (providing more jobs, as well as better public services such as social security, medical care, and education), (4) development in harmony between people and nature (stressing the saving of resources and environmental protection), and (5) harmony between domestic development and open door policy (adhering to open door policy while accelerating development of the domestic market).

(2) Unavoidable political reforms

Certain contradictions between the changing economic foundation and outdated political system have already surfaced, however, to the extent that the policy of “separation of politics and economics” that involves “political dictatorship” and “a free economy” is reaching its limits. Consequently, political reforms can no longer be avoided in China as it heads toward a mature form of capitalism.

Ever since China instituted reforms and open door policies, the country has followed the path toward a market economy while maintaining the one-party dictatorship of the Communist Party. As the economy develops, however, the values and interests of society have diversified, and conventional communist ideology that advocates class struggles has lost its appeal. In order for the Communist Party to maintain its one-party dictatorship under

such a new socioeconomic and political environment, it must now seek a new kind of justification. Such a sense of crisis prompted the Communist Party to focus upon improving its governance capability in the Fourth Plenary session of the 16th Central Committee in 2004.

Along with the progress made in economic and market development, China has also seen its people increasingly demanding a more democratic government. Economic development has not only improved the people's living standards, but is also transforming Chinese society into a modern industrial one. Given their changing lifestyles, people have also changed their values and are demanding greater political participation to realize a more suitable political system. Moreover, the development of a market economy is bringing about more diverse interests. People have begun to find participating in politics and forming interest groups necessary to realize their own interests.

The Communist Party is also finding it difficult to maintain administrative power without the support of the capitalist class and other emerging social forces. As China's market economy develops, capitalists has grown in number, and without the support of this burgeoning social force it has become difficult for the Communist Party to maintain its grip on power. It was in this context that President Jiang Zemin formally gave permission for party membership to be granted to capitalists in his address on the 80th anniversary of the formation of the Communist Party in July 2001. This was justified in a speech of key significance, known as the theory of the "Three Represents", which President Jiang delivered during his inspection tour of Guangdong Province in February 2000. The Three Represents Theory emphasizes that it is the Communist Party that represents advanced productivity, advanced culture and the fundamental interests of the overwhelming majority of the people of China. It represents a significant departure from the traditional Marxist dogma whereby the communist party is supposed to represent the proletariat only. If the Chinese Communist Party really were to become a party representative of all the people, by definition it would no longer be a communist party. Thus, rather than being a cosmetic reform, the Three Represents Theory may actually change the Communist Party fundamentally.

4. The three major events of the first half of the 21st century regarding China

China will continue evolving toward a mature form of capitalism instead of an advanced stage of socialism. In that process, historic events are expected to occur one after another by 2050 in this order: the end of one-party dictatorship by the Communist Party, peaceful unification of the mainland with Taiwan, and China topping the USA to become the world's largest economic power in terms of GDP (gross domestic product).

(1) The end of one-party dictatorship by the Communist Party

As we look back, the 20th century was dominated by the conflict between “communism” and “capitalism.” It ended with the overall defeat of communism as symbolized by the collapse of the Soviet Union. In China, although the communist government has remained intact, most people have lost their faith in communism. The Communist Party, with its legitimacy fading, will become unable to maintain its one-party dictatorship, resulting in China shifting to a more democratic political system.

The Chinese Communist Party is already attempting to broaden its base of popular support on the grounds of the “Three Represents” theory. Using this doctrine as leverage, the party is toning down its “one-party dictatorship” based on Marxism-Leninism, while exploring ways to shift to a “one-party dominant system.” Here, “one-party dominant system” means a political party system where one particular party with predominant, electorate-sanctioned political power among all other parties continues to run the government for an extended period as the center of a single or coalition government, under a liberal democratic system that basically permits the freedom of political activities (see *The Beginning of a New One-party Dominance* by Seizaburo Sato in *Chuo Koron* magazine, January 1997). In such a system, a change of government is not determined by competition among the political parties, but by coordination among the intra-party factions. The leaders are nominated by members of the ruling party, instead of being elected directly by the people through a voting process. Moreover, there is less dissent over policy within the dominant party than among the other parties, thus minimizing confusion upon a change of government. The Liberal Democratic Party that headed the Japanese government from 1955 to 1993 is a perfect example. If the Chinese Communist Party goes through reforms and comes to see its members elected by the people through the baptism of fair elections, then its legitimacy and capability to govern will be enhanced. In that sense, Japan’s “political regime of 1955” may become a model for political reforms in China during this transitional period.

(2) Peaceful unification with Taiwan

The second expected event would be the unification of China and Taiwan. Naturally, this issue will entail whether it involves military force or not. Should the mainland side become more powerful and Communist rule come to an end, peaceful unification will then become a reality. The Chinese Communist Party has targeted three major goals: maintaining its one-party dictatorship, maintaining high economic growth, and unification with Taiwan, but these goals cannot be achieved simultaneously. In other words, one goal must be sacrificed in order to achieve the other two. Consequently, future Cross Straits relations would follow one of three probable scenarios: “maintaining the status quo” (abandoning

unification), “unification through military force” (abandoning high economic growth), or “peaceful unification” (abandoning one-party dictatorship) (see Table 1).

Table 1 Three scenarios for Cross-Straits relations

	Maintaining a one-party dictatorship	Maintaining high economic growth	Unification with Taiwan
1) Maintaining the status quo			×
2) Unification through military force		×	
3) Peaceful unification	×		

[Source] Compiled by the author

1) The scenario of maintaining the status quo

The scenario of maintaining the status quo sees the Chinese government putting priority on maintaining the Communist Party’s control of government and the country’s high economic growth, while shelving settlement of the unification issue. Should Taiwan not outright demand its de jure independence, China would actually tolerate such de facto independence. Although there have been repeated confrontations between the two sides, economic integration has proceeded under the policy of “separation of politics and economics.” Particularly notable is the fact that Taiwanese companies are creating many job opportunities for the mainland through direct investment, thus greatly contributing to China’s economic development. Conversely, China only has limited means available regarding unification with Taiwan. Criticizing Taiwan’s current government and conducting large military exercises have adverse effects on trying to appeal to the compassion of the Taiwanese. Moreover, applying pressure to Taiwan through the USA may serve to increase American clout, and thus is not necessarily a good policy.

2) The scenario of unification through military force

Should China attempt to unify with Taiwan through military force, it might be able to maintain its communist government, but would have to sacrifice the country’s high economic development. If China launched a military invasion of Taiwan, the US military would probably intervene and make it doubtful whether China could win the war. Even if China emerged victorious, Western sanctions on China would be inevitable as was the case after the Tiananmen Incident of 1989, with an immeasurable damage on the economy. A Taiwan seized through military might by China would become a burden rather than an asset to China,

as Taiwan's economy collapses on the back of massive outflow of capital and human resources.

3) The scenario of peaceful unification

Peaceful unification means the Taiwanese opting on their own to "return to their homeland." The precondition would be that existing living standards, current levels of freedom, and Taiwan's form of democracy are ensured. With regard to that point, making such commitments as expressed by "One Country, Two Systems" implemented in Hong Kong would prove inadequate, as most Taiwanese citizens do not believe that the Beijing government would sufficiently respect these demands. All things considered, peaceful unification would entail for mainland China an economic and well as a political convergence toward Taiwan. Most Taiwanese do not trust the Communist Party and are reluctant to lose the fruits of democracy they have cultivated thus far; therefore, peaceful unification would not be possible as long as the Communist Party retains its one-party dictatorship.

Of these three scenarios, I predict that "maintaining the status quo" is most likely on a short-term basis and "peaceful unification" on a long-term basis. To date, China has declared its determination to use military force to prevent Taiwan's from gaining full-fledged independence; however, China has no actual intentions of accelerating its unification efforts by force of arms. A finely balanced state of affairs where Taiwan is neither independent nor under mainland rule is also the best option for the government headed by Hu Jintao and Wen Jiabao, which is pursuing a policy of securing China's "peaceful rise." At the same time, should China achieve modernization and become an attractive state in the future, Taiwanese citizens would be proud of being Chinese as well, and become increasingly interested in unification. Thus, unification with Taiwan will only be achieved as the result of China's peaceful rise.

(3) Replacing the USA as the world's largest economic power in terms of GDP

Upon democratizing its government and unifying with Taiwan, China's third turning point would be to top the USA in terms of GDP. The timing of such an event depends largely not only on the difference in the future real growth of both countries, but also on changes in value of the yuan against the dollar. In 2004, China's GDP was only 1.93 trillion dollars, equivalent to 16.4% of the 11.74-trillion-dollar level of the USA. Even if annual growth rates were set to 7% for China and 3% for the USA, the sizes of their economies would not be reversed until 2052. When considering the likelihood of the yuan appreciating significantly against the dollar, however, such an event would occur sooner than projected.