

# Is the East no Longer Red? China's Erratic Flirtations with Markets

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*The assumption of control of the levers of power by Deng Xiaoping and the implementation of economic reform in China have yet to play out to a logical end. Despite optimistic and bullish evaluations of the future prospects for China's economic future, there are numerous uncertainties which should be assessed. The first area of concern is that the reported estimates of economic growth are highly misleading. In light of this observation, the rush to invest in China may be premature and may involve a speculative bubble which is both a cause and an effect of inflows of Western capital. Also, there are likely to be dimmer prospects for profitability of foreign investments in China.*

*Several other issues are also addressed here. Claims for the successes of China's «gradualist» market reform also invite scepticism. Additionally, the impact of Confucianism and the continuing role of the Chinese bureaucracy in the development of markets is considered. A final and over-riding issue considered is the conditions for and consequences of the fractious pressures on China which threatens the hegemonic integrity of the ruling Party.*

**Keywords:** Economic Growth; Marketisation; Modernisation Programme; Gradualism

## Introduction

There is much excitement about the development pattern evident in China's «modernisation» programmes. A chorus of praise points to a widely held acceptance that China's economic growth rates have exceeded all previous attempts of backward economies to grow out of impoverishment (Overholt, 1993). However, a few scholars have questioned the reports of China's super-charged growth on various grounds (Lingle and Wickman, 1994). Aside from the tradition of routine falsification and/or exaggeration of economic performance of Soviet-style economies, numerous incongruities emerge from an investigation of the economic dynamics which must be necessary to underpin such high rates of economic growth.

As elsewhere, China's socialist bureaucracy must implement policies to promote a reasonably fair distribution of the fruits of continued economic growth to ensure political stability. For China's economic growth to keep pace with its more energetic Asian neighbours, it shall require access to technology and to massive amounts of foreign capital investment. However, various elements and conditions described below pose a threat to the continued existence of the political entity known as the People's Republic of China. In all events, foreign investors are likely to find their expectations thwarted by the business realities, the bureaucratic interferences and their own unrealistic projections for market developments in China. Unless dramatic improvements are made in these areas, the opportunities offered in other Asian and non-Asian markets will draw investment capital away from China. In turn, this is likely to reduce the Chinese regime's ability to use its economic growth record as a means for legitimating its authority.

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## China's Economic Growth: Facts, Fantasies and Fraud?

China's real economic growth is reported to have averaged 8-12% over the past 15 years. However, such estimates are questionable due to numerous difficulties in calculating economic growth in China. Perhaps the most obvious source of scepticism is the possibility of the politicisation of data within China. As with statistics from other closed countries, there is an historical tendency to conceal economic realities. The very high growth figures certainly serve the purpose of the Chinese authorities to claim success in boosting economic performance. Over-estimates of East European economic output are now painfully evident in the case of the former German Democratic Republic.<sup>2</sup> Misleadingly high estimates of China's growth are also likely to be the result of the monetisation of the economy whereby previously non-reported barter production is counted in output figures.

Several problems arise out of acceptance of these illusory growth figures. First, a substantial amount of pension and mutual funds from Western investors is at risk in what might be a speculative bubble. Second, other alternative investment targets are being overlooked, for example, East and Central Europe. Third, these high growth figures are often presumed to be generating a middle class which shall place political constraints on the Chinese regime. The importance of this last point can be seen in the context of arguments in support of expansion of China's trade privileges, especially GATT membership.

### *Divergences in China's Reported Growth Figures*

Reports of super-charged economic growth in China should be viewed sceptically, especially due its vast domain and economically diverse regions. Disparities among the provinces have either arisen or have been perpetuated due to failures of past economic policies. Common sense alone should raise serious questions about the overly-optimistic growth figures for China. For example, it seems improbable that an enormous and disparate country should suddenly and for an extended period grow twice as fast as Japan during its high growth period. Similarly, it is even less likely that Chinese growth significantly outdistances smaller and much more homogenous in East Asia.

Some explanation can be offered for the existence of the puzzling consensus among so many interested parties. A trivial explanation might be that *nominal* rather than *real* growth figures are reported. This is unlikely. However, widely reported estimates of 14% real growth for the first half of 1993 were made without reliable data on price changes. Preliminary real growth estimates for 1992-93 have to account for inflation rates of perhaps 20-25%. Such high rates of inflation imply *negative* real growth for certain provinces, possibly even for China as a whole. On the basis of such unreliable indicators of *both* output and inflation, estimates of real growth should be treated with the utmost caution.

It is likely that the booming and undoubtedly fast-growing maritime provinces have provided a Ptolemy-like appearance of equally high performance behind the «facade». Foreigners have long had ready access to most of the coastal areas, especially Guangdong which is undergoing a dramatic boom. Yet the economic conditions of the maritime provinces are significantly different from most of the rest of the mainland. The interior provinces do not enjoy the same material gains nor do they have the same access to modern technologies as do the coastal provinces.

In fact, the interior provinces are variously disadvantaged, both in relative and absolute terms. These problems are compounded by the fact that an open national market network has not developed in China. Goods produced in one area are more likely to be found in foreign markets than in other parts of China. This is due to problems of transportation infrastructure and the tendency for the output of joint-ventures to be targeted for export. In any case, the economic record is substantially different. Despite the growing importance of village enterprises, most industry is found in the maritime region. Inasmuch as industrial growth was 6 times faster than in agriculture (Hornik, 1994), it is plausible to assume that the central provinces are falling further behind the periphery.

### *Implications of Overestimates of Economic Growth*

Several problems emerge out of the excessively optimistic growth figures for China. In the first instance, there is an illusion of the beneficial impact of high growth upon the development of a middle class. This in turn has its own implications. On one hand, announcements of world-beating growth rates create expectations

about a vast number of eager consumers. Due to the uneven distribution of growth the widely discussed prospect of 1.2 billion consumers is a wild exaggeration. It is not likely that the next decade shall see significant increases in wealth and income beyond the 10-15% of the population which resides in the coastal provinces. Absent the formation of national markets and the infrastructure to support them, it could be longer.

On the other hand, unsubstantiated rumours about high growth and a growing consumer class is drawing international capital into a potential quagmire or perhaps a speculative bubble. The direct consequences of this gloomy prospect should be rather clear. The indirect effects are that other investment opportunities which might provide lower risks with more promising rates of return are being overlooked in the frenzy to develop a business presence in China, e.g. India, Indonesia, East and Central Europe and Latin America.

In all events, there are numerous reasons why estimates of Chinese economic growth should be viewed with great scepticism. In the end, uneven economic growth in China since 1979 points has led to heightened regional tensions. These tensions and other centrifugal forces combine as a threat to the possible break-up of this economically disparate country, as shall be discussed below.

## **China's Economic Transition**

There is ample evidence that the Chinese authorities have little understanding and scant trust in the outcomes of market processes. In this sense, China's «modernisation» moves forward in fits and starts. However, there are some readily identifiable elements of the transition programme. The outcomes of the transition process in China as elsewhere must be understood within an historical context. Due to experience with extensive state intervention and an obsessive intent to maintain political power in the hands of the Party, the dead-hand of government remains widely evident. Thus, gradualism as the transition chosen path is not based upon a theoretical model. Instead gradualist policies were motivated by a tendency to manage and to control developments. This tendency is also evident in the emerging signs of Chinese macroeconomic stabilisation policies. These reactions to the contradictions have become more apparent due to the unavoidable imbalances associated with half-hearted marketisation procedures.

### *Gradualism or Big Bang?*

There is an apparent lack of consensus over the best course for economic policy responses during transition from authoritarian socialism to full-fledged market economy. Most observers find themselves in one of two opposing camps, often identified as the «accelerationist» and «gradualist» approaches. Supporters of the accelerationist are guided by a need for rapid institutional changes, i.e. a «short, sharp shock». Gradualists promote a step-by-step, piecemeal process. A related issue in the identification of approaches to economic transition relates to the substantive differences in reform versus transformation. Transformation is radical and fundamental restructuring whereas reform may merely involve tinkering with established institutions.

An important observation is often missing in discussion of the intention or effect of transition policies. It must be recognised that many of the observed economic problems during transition are the hangover effects of communism. In other words, rather than being the result of a chosen transition path, an unavoidable systemic chaos arises out of the inherited institutional framework of communism. These institutional frameworks then are the source of observed inefficiencies and irrationalities of the transition process. Disregard for this aspect of the experience of post-communist regimes can lead to a confusion of symptoms with cures. As a consequence, interpretation of the progress of actual transition policies may not clearly delineate the qualitative differences in alternative approaches to systemic change. The «vicious cycle» of underdevelopment and economic upheaval (shrinking output and rapidly rising prices) arises out of the pre-existing conditions determined by communist institutions.

Support for the accelerationist strategy arises out of a commitment to real and rapid transformation. Economic as well as political rationale can be summoned in support for the this approach. The economic effects of rapid and sweeping implementation can convey political payoffs. Bunching reforms at the outset can involve a sort of «economy of scale» upon the structural incentive adjustments within both the polity and the economy. In such situations, the unavoidable costs of economic rationalisation can be offset by some

immediate benefits. Implementation of private property as the basis for a rational pricing system and monetisation of the economy are important initial steps. However, the hidden, non-monetary costs of socialism (shortages and queues) disappear while the transition costs (rising prices and unemployment) are associated with the transition programme. Voters tend to be short-sighted. The sooner the worst of the adjustments are experienced, the greater shall be the political payoffs to elected officials. A slow transition path allows the recollections and disadvantages of queuing, shortages, the poor quality of goods and the lack of imports to fade into the distant past. Conversely, rapid implementation can limit the ability for interest groups to form in order to obstruct the more painful, yet necessary, changes.

One of the common arguments set forward by gradualists is that the conditioning of socialism leaves the afflicted populations ill-prepared to confront the chilling conditions of capitalism. A counterpoint to these claims is that Chinese peasants, despite their complete lack of experience with the market, adjusted with great alacrity to agricultural reforms. In general, the strategy of the gradualists is reform-oriented, in that deep changes in institutions are put off an uncertain future time frame. Piece-meal reform obscures the true source of painful economic distortions. Thus, as suggested before, many observers shall be inclined to confuse symptoms of the hangover with the prescription for the cure.

Although the theoretical arguments may be inconclusive, the outcomes of observed transition undermine the gradualist approach. Beginning with an evaluation by region, the European experience reveals consistent evidence in support of the accelerationist approach. Estonia and Poland are competing for the highest rates of economic growth in all of Europe. The Czech Republic, under the capable direction of Vaclav Klaus, chases the economic growth leaders and has unemployment of 3.5%. Hungary is attracting massive amounts of foreign capital. Meanwhile, despite suggestions to the contrary, Russia is the archetypical example of gradualism. Mikhail Gorbachev, and most of the so-called parliament which Yeltsin inherited, was rigidly opposed to private property ownership. Latvia and Lithuania and the Ukraine suffer from a new chronic form of «stagflation» which is common to East European countries which have followed gradualist policies.

In the Asia-Pacific region, New Zealand is the most notable success of accelerated economic transition policies. It has enjoyed a remarkable recovery from the suffocating effect of socialism imposed by decades of Labour market policies and economic corporatism. It is also arguable that China's early successes with agricultural reform were, if not at least a «mini-Big Bang», then it was perhaps a «big push».

China's piecemeal approach is often cited as a successful experiment in gradualist transition policy (Overholt, 1993; Shirk, 1993). The presumed superiority of the slow and gradual reform strategy, as developed in China, has also been promoted in Laos and Vietnam. However, Poland, Hungary and the Czech Republic are showing rapid benefits from massive sell-offs of state enterprises. These actions have reduced the economic drag which China faces as loss-making state enterprises continue to require subsidies. Delays in privatisation allow inefficient state-owned firms to absorb tax resources, greatly increasing the unpredictability of the entire marketisation project, as is increasingly evident in China. In all events, rapid transformation forces hidden unemployment into the open. Gradualism allows an unsustainable illusion of continued employment. High rates of unemployment and sagging production associated with economic transition are actually residual elements of the failures of socialism. Therefore, the full and sustainable benefits of marketisation depend upon rapid removal of impediments to market processes.

The issue of the universality of China's gradualist approach raises various questions. European transition began with democratisation. Reformers in China, as in Vietnam and Laos, continue to operate within authoritarian regimes. Attempts to control an economy are obviously different within a democracy than under dictatorship or autocracy. Democracies tend to allow citizens to seek out the individual means for fulfilling their life purposes. If citizens wish to undertake new enterprises, democratic governments try not to crowd out the new entrepreneurs. In order to reach the full benefits of marketisation, socialist economies must implement and enforce private property rights. Provision and protection of such rights shall eventually give rise to a code of personal rights and freedoms. Interim steps require a scaling down of government intervention and abandoning the tendency of socialist states to hoard labor. A reasonably rapid withdrawal of the communist state sector is the best hope for China and East Europe. Reluctance to reduce state intervention will limit future growth prospects and restrict the emergence of individual rights since the embryonic private sector is a necessary engine of economic growth. Similarly, restraints upon political freedom shall retard the development of individualist institutions which are necessary for an entrepreneurial-driven economy.

Thus, the «successes» of China's gradualist reforms should be viewed as being motivated by an opportunistic political agenda which has limited long-term growth prospects. However, like other Asian authoritarian regimes, China is clearly not restrained by democratic impulses. Export-led growth can be accomplished when prison labour is used to create an artificial competitive advantage. Similarly, trade unions continue to be suppressed or co-opted in order to restrict rising wages and living standards of their citizens. These examples provide evidence of the abuses adopted by non-democratic, gradualist reformers. It would seem unwise to recommend practices of gradualist reform, especially if they can be applied to prop up morally and politically corrupt regimes which impose economically irrational policies. In all events, material success is a much-too-limited benchmark for «success». Further, it is also questionable whether such regimes are capable of generating conditions for long run stability.

In fact, close inspection reveals less impressive gains from China's piecemeal reform agenda. On one hand, some of the real successes have depended upon the entrepreneurial skills and capital provided from overseas Chinese. Hongkong and Taiwan continue to serve as trading partner, financiers and intermediaries. On the other hand, incomplete reform has obstructed economic advance much more than the reported growth statistics suggest.

### *Macroeconomic Stabilisation Policies*

China's record upon recently enacted economic policy provides a strong source of scepticism about the prospects of gradualist reform to deliver long-term economic growth. This is most clear in the continued dependency of the central bank. The dominance of political decisions has contributed to a policy of negative real interest rates induce an artificially high demand for and inefficient use of investment funds. The erratic attempts to decide upon and to implement a stabilisation policy reflect the confused programme for reform. Austerity measures imposed during the Summer of 1993 were abandoned by the Third Plenum of the 14th Central Committee of the Chinese Communist Party (CCP) to promote «maximum growth». More recently at the 8th National People's Congress, new policies have again been announced as a means to restrain economic growth. Price controls were announced instead of a commitment to place effective restraints upon monetary growth rates as a means to arrest inflation.

The inability to control money supply growth arises out of China's crude monetary system which is guided by political decisions rather than economic rationality or commercial viability. Credit policy driven by short-term political considerations is likely to be a source of unstable economic growth. Efficient firms will tend to be prevented from acquiring necessary credits in response to their production plans. Meanwhile, inefficient state firms are likely to be subsidised, while increasing their inventories of un-marketable goods and maintaining their stock of underemployed labour.

China's unpredictable macroeconomic stabilisation policies inspire little confidence for future stability. Price controls on various products were imposed in December 1993, and ambitious plans for expansion of such controls were announced in March 1994.<sup>3</sup> This signals either an admission of an inability to control monetary growth as a source of inflation or an abject ignorance of the historical failure of price controls to have their desired effect (Schuettinger and Butler, 1979).

### *China's Choice: Bureaucracy Against the Market*

The ongoing struggle of productive forces against rule by the Chinese bureaucracy represents an important contribution to understanding the post-modern world. As the end of the 20th century draws to a close, parallels can be drawn to movements observed at the end of the 18th century. Now, as then, there is a global demand for the end of the privilege of the «ruling class» (e.g., whites in South Africa, the Communist Party in centrally planned economies as well as assorted despots and autocrats worldwide). A «new enlightenment» has arisen whereby state intrusions can be understood to be an important source of human suffering. In the 18th century and before, democrats constructed parliaments as a means to limit the actions of monarchies to confiscate their property and product, especially by restricting the power to tax. Ironically, this same struggle is presently being fought by citizens against their parliaments and governments which have evolved into the new and powerful transgressors. In China, this conflict is being played out in a complex game between independent entrepreneurs, local and provincial government against the communist regime.

Government officials almost always insist that their policies are based upon intentions to serve the general public. However, this political posturing is too often either a guise for their own abuse of power and/or to provide and to maintain privileges for politically influential (rent-seeking) interest groups. The democratisation process of China shall eventually follow other civilised countries in seeking to empower individuals by defining constitutional means for dis-intervention by the state and for the eradication of rule by unruly bureaucrats.

History has exposed the fatal flaws of the Marxian vision of an irreconcilable conflict between the capitalists and the proletariat. A modern «class struggle» involves a ruling class of bureaucrats and party apparatchiks who oppose the productive class which is composed of entrepreneurs and workers. The modern ruling class uses the tools of the state (violence and coercion) to maintain power and it enriches itself as well as its supporters at the expense of others. The productive class relies upon market processes (cooperation and exchange) to improve the lot of others while enriching themselves. Dealing with bureaucrats in China and elsewhere is too often a Procrustean nightmare where people are fitted to the rules rather than the reverse. The present generation of Chinese rulers seems unable to recognise that unnecessarily extensive regulations and inappropriate rules provide irresistible incentives for corruption. Rather than mend their own ways, the bureaucracy imposes the ultimate form of «re-education» on corrupt officials, execution. The Tiananmen Square incident was only the first round in the battle against the authority of the Chinese bureaucracy. The recent imposition of a new tax regime along with wage and price controls signals Round II, with its principal focus against unrepentant capitalists and independent-minded government officials in the provinces.

### *The Way Forward?*

In support of China's approach to reform, it has been argued that authoritarian regimes are well placed to force through unpopular measures which are necessary to marketise an economy. Those who support this point of view find the political costs of continued repression to be acceptable. Ironically, this claim deflects arguments against the implementation of rapid economic transition. If political costs can be readily ignored, the more rapid the transition process, then the economy can move more rapidly onto a higher growth path.

While erratic implementation of stabilisation may itself be destabilising to the economy, the current mix of policy is likewise counter-productive. One of the principal concerns of the communist regime is to maintain employment levels in order to forestall unrest. However, the continued presence of negative real interest rates and mounting budget deficits is both symptomatic and causal in the impending unemployment crisis.

Negative real interest rates reduce the cost of capital relative to labour, inducing producers to shift toward capital-intensive processes. This can only lead to disastrous results in an economy which has a vast labour surplus. Refusal to raise interest rates is related to the growing budget deficits. While tax revenues to the centre have been substantially reduced, there has been little success in reducing expenditures. Subsidies to state enterprises have become one of the most significant sources of drag on the Chinese economy. First, not allowing the firms to go bankrupt means that they will divert tax expenditures from other government programmes and bid away resources from more productive economic activities. Second, the continued dominance of state enterprises adds rigidities to the labour market.

The remedies are simple, if not easy to implement. Interest rates must be allowed to rise, in order to encourage more rational use of capital and greater intensity in the use of labour. If accomplished through tighter monetary policy to rein in money supply growth rates, this should also restrain inflation. State enterprises must be allowed to go bankrupt or to be restructured through privatisation. A sound and just commercial code must accompany complete transformation of exchange rate policies to provide greater confidence to foreign investors. In the end, the Chinese regime shall have to abandon the dominance of political expediency over market-related policy in order to achieve the economic growth rates necessary to absorb the annual entry of 50 million or so into the labour force.

### **Confucian Culture, Individuals and Individualism**

This section explores the impact of Confucian culture upon patterns of and prospects for economic advancement in China and other parts of Confucian East Asia. While the observed Confucianist regimes

exhibit pursue goals which are ostensibly communitarian, there is an attempt to promote the role of the individual as an entrepreneur. An unstable equilibrium should be expected to emerge since entrepreneurs are conspicuously individualistic, contrarian and generally defiant of established orders.

### *Economic Development in Confucian East Asia*

Economic performance in China and selected other economies in East Asia is often said to embody one of the great economic success stories of history (World Bank, 1993; Chowdhuri and Islam, 1993). Of these major new global players, Hongkong (under British colonial rule until 1997) and the countries of Korea, Singapore and Taiwan are linked historically and culturally through Confucianism. This entrenched value system has had an important impact upon the development of institutions in this region which in turn influence current economic performance. Following this line of reasoning, some projections are offered on the future institutional change within this cultural setting.

The process of economic and social advancement in Confucianist cultures is constrained by the paradox described above. On one hand, governments have sought to legitimate their exercise of a degree of authoritarian power (often coincidental with a substantial degree of social harmony) by appealing to Confucian tenets of respect for authority and adherence to long-standing traditions.<sup>4</sup> In this context, the individual is expected to put society above self. Individual interests are to be subordinated to the interests of the community (or at least those identified by the ruling political party). On the other hand, these same governments also recognise that their legitimacy depends upon «performance» criteria, especially in terms of economic progress. The links between the delivery of economic performance as a means for community advancement is well understood to depend upon entrepreneurial actions within open and competitive markets.

In this context, individual action in pursuit of individually-chosen, subjective goals will often appear to be in conflict or to be distinct from others in the community. Contrary to the Confucian precepts, «real» entrepreneurs seek their own identity and tend to view their actions as serving their own ends rather than to serve as a means for others in the community. Logic suggests that these inherent contradictions constitute an unstable equilibrium which requires constant attention and an unerring, steady set of hands.<sup>5</sup> Otherwise these incongruous forces become in open conflict with some of the other aims of governments in a Confucian context, including a threat to their continuity. Like other activities which require micro-managing and continual fine-tuning, maintenance of this balance is likely to be very difficult, if not impossible.

What follows is an investigation of the arrangements and outcomes of institutional structures within communities with historical and/or political links to Confucianism. In order to trace out a scenario for the future resolution of the paradox described above. First, it shall be necessary to come to an understanding of the characteristics and actions of entrepreneurs. Further, a complete understanding the entrepreneur in a Confucian or any other culture requires an examination of the role and concept of the individual and individualism in that culture.

### *«Real» Entrepreneurs as Agents of Change*

A variety of definitions can be found to identify entrepreneurs in terms of a variety of characteristics including risk-taking behaviour, innovation, ownership, profit-making or taking or control of resources (Hebert and Link, 1988; Sexton and Kasarda, 1992). Of three general categories, the first focuses upon the tendency to start-up and manage new businesses. A second interpretation points to growth and pursuit of opportunity (Sexton and Bowman-Upton, 1991). A third definition is seen to be more complete and exclusive. It focuses upon innovation (Kirzner, 1973) whereby entrepreneurial actions result in new arrangements of resources which improve upon and replace existing arrangements.

The first two definitions allow for an interpretation of entrepreneurship which is too wide and on their own do not reveal the essential qualities of entrepreneurs. Entrepreneurship does not necessarily involve success nor growth. Indeed, entrepreneurs do fail and this possibility of failure is what characterises the activities of true entrepreneurs. Thus, while innovation is a defining quality, risk taking is also a necessary feature. Individuals whose access to markets is protected or provided by government edict do not satisfy the criteria associated with entrepreneurship.

Thus, it is necessary to draw a distinction between real and mythical entrepreneurs. Real entrepreneurs

are risk taking innovators who operate within the market without governmental assistance. Their fortunes depend upon their own initiatives and ability to circumvent restrictive rules. Mythical entrepreneurs operate with the complicity of governments or political parties. Their fortunes are dependent upon their loyalty to a particular political order or adherence to a set of rules. Identification of a real entrepreneur should not depend upon the degree of (material) economic success. This may be misleading, especially in the case of special access or limits upon competition provided by governments to «buy» political loyalty. The natural condition of real entrepreneurs is to upset the status quo. These habits in the market place may be easily transferred to the political realm. Those entrepreneurs who are able to make their fortunes without government assistance are not likely to feel beholden to any political order. In fact, due to the tendency for governments to intervene and to restrict contract arrangements between private parties, real entrepreneurs may tend to have a disparaging attitude towards governmental authority.

### *Unique Business Arrangements in China*

In order to protect or to promote the status quo, it is not unlikely that many «entrepreneurs» are carefully selected individual, perhaps cronies of the ruling party, to whom special treatment offers mutual advantage. Instead of self-selection through possession of special skills, many, if not most of the observed entrepreneurs are likely to be those with the best connections or relations with the ruling parties. Thus, it may be to the benefit of governments to establish a myth around entrepreneurial action which is operationally little more than special access to economic markets.

Numerous problems for investors arise in any country undergoing such dramatic transition towards marketisation of its economy as is China and East-Central Europe. One of the most significant considerations is the primitive development of the treatment of business enterprises with the legal system. Most of the laws cover statutes which relate to criminal or political matters. There are few independent lawyers to assist with legal interpretation or litigation. «Guanxi», private connections, continue to be the most important determinant of the outcome of administrative rulings. In turn, administrative rulings are the most decisive component of conflict resolution. Thus, those with personal or family contacts are able to secure special advantages. However, it is too often overlooked that *guanxi* is a zero-sum game, i.e. access by one individual is offset by lack of access to another. A dynamic system depends upon positive-sum games in order to allow growth.

The enormous and uncontrolled capital flight out of the country is only one indication of the problematic black market operations in China. The central government has lost control of the growth process and black market speculation, corruption, capital flight, deteriorating living standards for a substantial proportion of the peasant population are characteristic of conditions in China. Absent of government backing, the suppressed Chinese «business class» builds up and conceals its wealth in the black markets, outside the grasping purview of central government and provincial tax collectors.

### **Economic Freedom and Demands for Political Liberty**

Discussions of the link between Chinese economic growth and post-reform economic and political freedoms begin on uncertain ground. One of the most problematic aspects of this issue arises out of the presumed linkage in the operational notion of «property rights» in China. This issue is of extreme importance, since many observers expect that the current embodiment of property rights can support the rise of embryonic Chinese middle class. Most observers expect that a bourgeoisie shall muster the economic strength and political will to demand greater freedoms.

However, the absence of full resale rights for landed property limits the emergence of a middle class by retarding formation of property markets. Those «markets» as they might be seen to exist involve extreme restrictions placed upon participants in these transactions. Full scale markets operate on the basis of a process of bid-and-offer. However, property prices in urban areas are unilaterally set by the government and negotiations are non-existent. Similarly, property rights for peasant are tentative. Under post-Mao market reform, access to agricultural land consists of non-transferable leaseholds.

Apart from property ownership, another important precondition for the growth of a full-scale middle class is to allow greater private control over capital. It is unlikely that a vibrant and politically independent middle class with business-oriented interests shall emerge when severe limits are placed upon their autonomy



in production decisions. At the moment, Chinese law obstructs economic independence through extensive bureaucratic control of most resource and financial markets. It is unlikely that there shall be a wholesale removal of these controls by Chinese authorities. Such a retreat would pose a threat to the permanence of the political hierarchy, since maintenance of such rules provides an important source of power. Given the current levels of corruption, this power seems to be exercised often for the personal enrichment of Party cadres.

As a consequence of extensive bureaucratic controls over various sectors of the economy, many of the members of the observed middle class seem to be in a dependency relationship with the Communist Party. Apparently, there are no long-term plans to encourage the growth of a broader, more independent middle class. In a recent interview, Vice-Premier Zhu Rongji declared that while the economies of the West would be based upon private ownership, the Chinese economy would be based on socialist ownership. In fact, one definition of China's hybrid, «market socialism» is a market economy without capitalists. Given the influences of Confucianism and the continued, explicit constraints upon entrepreneurs, there is little hope for a rapid development of a vibrant middle class. While they may become wealthier, Chinese citizens are unlikely to develop the will or the ability to force democracy upon a reluctant socialist bureaucracy in the near future.

### **The Future for a Centralised China**

To suggest such a cataclysmic event as the breaking up of China (PRC) is undoubtedly a contentious issue. However, the only way to prepare for or to prevent events of such imponderable consequence is to dare to ponder them.

Such musings should not be dismissed on the suggestion of a hidden agenda based upon strategic concerns. Certainly the destabilisation of China might be seen in some quarters as a desirable means to weaken its territorial claims in the region. Neither should it be suggested that if an imagined break-up *could* have occurred then it *would* have occurred when «morale was at its lowest point after Tiananmen». It is not clear whose morale was low after Tiananmen Massacre. Certainly the CCP leadership was firmly in control, and there were very few signals of dissent within the PLA. It seems clear that the Chinese peasantry, the vast majority of the population, were either unaware of or unaffected by the slaughter of their fellow citizens in Beijing. Without involvement of the peasantry, there would be little fundamental change in the Middle Kingdom.

Nor is it adequate to suppose that the dominance of Han Chinese, constituting as they do 90% of the population, shall serve as an adequate guarantee against a break-up of China. Racial or tribal homogeneity has seldom been enough to eliminate internal strife. Civil wars are fought among people of the same racial characteristics. Separatist violence in countries occurs among people of the same race, though often of different ethnic or cultural backgrounds. Similarly, assertions of the hegemonic tendencies of shared racial characteristics ignore China's own recent struggles of the communists against the KMT.

In fact there are dramatic signs of a weakening of the grip of the central authorities which signal the necessary (but not sufficient) weakening of central control which might lead to an hypothesised break-up of China. There have been reports of a widespread increase in one of the most pernicious problems to have plagued pre-Liberation China, «warlord» activities. Combined with the re-emergence of warlords is the abuse of power by municipal and provincial officials. A ready explanation for these events can be found in two circumstances. First, the uneven development of regions which has been promoted by inefficient economic policies associated with CCP rule. Second, related to the above is the destabilising effect of inflation which is coincidental with current reform.

### *Regional Disparities and Destabilisation*

Central planning and extensive state intervention in economic and social affairs, have contributed mightily to uneven regional economic development within China. Here we shall reverse the Baran's and Frank's «underdevelopment thesis» which pointed to *capitalism* as the principal cause of underdevelopment in Third World countries. It can be applied with great success here to explain the failure of authoritarian socialism to insure balanced economic growth in China. In all events, an explanation must be found to

explain the extensiveness of poverty and the highly uneven distribution of economic development within a country so strongly committed to socialism. There is no need to challenge the entire corpus of Frank's or Baran's work. However, most of the historical influences described in their model to explain Latin American underdevelopment might be interpreted to relate to mercantilist (i.e., non-private and state dominated) policies which predated capitalist, private initiatives. Indeed, arguments alleging that capitalism provided sufficient preconditions for the historical impoverishment of Latin America might be seen to be as tenuous as would be an assertion that the forces of capitalism were the cause of the current problems of underdevelopment in China.

It can be argued that central planning and socialist experiments generated, maintained, and deepened economic underdevelopment in various regions of China. As in other socialist economies, evidence of the loss and misappropriation of economic surplus is clearly seen to have occurred during the grand experiments of Chinese socialist development. It might be argued that the contradictions of uneven development arose out of the effects of rigid central planning and single-minded concentration upon industrial expansion. Likewise, the rigidities associated with the monopolistic nature of socialism, undoubtedly contributed to China's regional polarisation within China. This polarisation is undoubtedly the source of some centrifugal forces which threaten the hegemonic cohesion of the CCP. Interesting results arise out of applying the logic and vocabulary of Frank's model to analyse the consequences of socialism rather than capitalism. What one sees is that the «contradiction of the expropriation or appropriation of the economic surplus of the satellite (traditional) sector by the modern, industrial sector» of the Chinese economy resulted in a continuous state of underdevelopment of the rural sector. Due to recent changes in economic policy in China, an apparent consensus now acknowledges the persistence of the underdevelopment generating/perpetuating contradictions of central planning.

China's peasants were perhaps the most exploited victims of socialist-inspired policies. They suffered from low income due to depressed agricultural product prices and had little access to the social amenities available to urban workers. The broad urban-rural disparity in earnings, incomes, and monetary value of output has been aggravated over time while peasants' real incomes either stagnant or fell. A recent report cited that income for urban residents was 2.7 times greater than rural residents (Hornik, 1994). Collectivist policies have not been sufficient to correct underdevelopment in China and may have certainly exacerbated regional income disparities. Socialist policies seemed destined to perpetuate and to deepen regional divisions. These historical pressures combined with the stresses associated with economic transition threaten the continuation of centralised rule in China.

### *Inflation and Decline of Central Authority*

Political leaders in China express the same fear and loathing of inflation as do their counterparts in Germany, and for the same reasons. Hyper-inflation is associated with the eventual collapse of the KMT's control over the mainland (Bianco, 1967: 160-61). Added to this dread is that the effects of uncompensated inflation are credited for the rise of the so-called democracy movement.<sup>6</sup>

The spectre of inflation continues to haunt the Chinese leadership as they attempt to reconcile the contradictions arising out of the economic modernisation process. Economic reform from a communist, centrally-planned state results in inevitable re-distribution, both in relative and absolute terms. Losers can be dealt with in several ways. They can either be bought out or beaten politically. In the latter case, this would involve imprisonment or exile.

The former case is more interesting as it involves co-opting a potential source of political opposition through compensation. One of the most sensitive sources of potential instability is the vast amount of personnel which depends upon continued largesse from the central government to support inefficient state-run enterprises. In light of the continued politicisation of central banking practices, continued subsidies to these loss-making state firms will continue to contribute to inflationary pressures. Two thirds of Chinese state enterprises either run operating losses, or are in financial difficulties. Total losses for 1993 increased by over 20% and exceed US\$5 billion (Hornik, 1994). The acknowledgment of high and rising inflation in the first months of 1994 confirms that political tensions remain a significant source of unresolved conflict. What is apparent is a sort of inflationary cycle where early stages of inflation are a response to and then a cause of political instability.<sup>7</sup>

The recent retreat of Chinese authorities from austerity may reflect an acceptance of reality by the central bureaucracy. The central government continues to be weakened relative to the high-growth provinces. The extremely uneven economic growth patterns in China reveal decisive contradictions. These are further complicated by inflation generated by the high-growth maritime region which imposes uncompensated price rises upon the less developed provinces. Attempts by central authorities to introduce redistributive policies to aid the relatively poor and depressed majority is likely to face stubborn resistance by the more prosperous minority of the coastal provinces. Control over tax resources is a continuing source of friction which weakens the CCP and threatens the survival of centralised political control.

Essentially, inflation is both a cause and an effect of the erosion of the power of the central bureaucracy. The proportions of total tax revenues collected by central authorities continues to shrink relative to the funds captured by provincial authorities. Reduced to a «dependency» status, the central government continues to lose influence over provincial affairs. Unless the shortfall in taxes is balanced by reductions in expenditures, budget deficits will begin to rise. The initial response to this growing gap was to finance it through inflationary injections of newly printed money.

## Conclusion

Thus there is ample evidence that power has drifted out of the hands of China's central socialist bureaucracy. Further indication of this is that corruption, even among high level party cadres, is reaching epidemic proportions. In fact, 10% of all criminal cases heard in China involved Party or government officials (Hornik, 1994). Struggles continue over attempts by the central government to raise its tax base which conflicts with provincial authorities who jealously guard their own revenues. Imposition of austerity plans has been spasmodic as they impinge upon provincial growth targets especially in the maritime region.

China's long march toward widely-shared prosperity seems likely to result in a different political architecture. A federal option or a total break-up are but two possibilities. Regional ties have been strengthened due to increased economic convergence as well as historical and ethnic bonds. In this sense, Taiwan has forged the same sort of links with provinces of southern China as has Hongkong. As elsewhere in the world, these regional forces shall strain the fabric of the nation-state.

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## Endnotes

- <sup>1</sup> While of the content of this paper has been influenced and improved by insights from my inestimable colleague and friend, Dr Kurt WICKMAN, I alone bear responsibility for any defects in the manuscript. The author also acknowledges financial assistance from the Institut d'Estudis Catalans and CIRIT which enabled the paper to be presented before the Societat Catalana d'Economia.
- <sup>2</sup> The certainty of hindsight requires total dismissal of estimates which portrayed Soviet per capita income to be near that of Spain in the 1980's.
- <sup>3</sup> Price increases have been limited on at least 20 widely used commodities and services. These ceilings include many of the staple foods in China, energy sources, public transport and fees for schools and hospitals.
- <sup>4</sup> The core Confucianist values include discipline, keeping peace with neighbours, society above self, reverence for scholarship, as well as loyalty and respect for authority. This latter injunction involves a variety of hierarchical relationships, including between generations (filial piety) and between ruler and the ruled (loyalty to the state).
- <sup>5</sup> Of course it is possible to resolve this paradox by suggesting that ruling parties simply attempt to bind Eastern values into a national ideology which they in turn direct for their own purposes. In this setting, real entrepreneurs are replaced by those who are close to the government officials.
- <sup>6</sup> It is widely believed that the popular protest which led to the Tiananmen massacre was a response to inflationary pressures. More important, the price increases resulted in a general real decline in standard of living for the bulk of the population on fixed incomes. Students were especially affected since they have no real output which they could use in barter trade to offset rising prices.
- <sup>7</sup> One aspect of the political economy of reform appears to be the introduction of a «reform cycle». Attempts to micro-manage reform is likely to have the same outcomes of micro-managed economic stabilisation policies. Whereas «political business cycles» are observed in Western democratic industrialised economies, reform can be expected to generate similar distortions and uncertainties which have their own responses. In both instances, we observe «policy-induced» business cycles.