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**The Emergence of Capitalism in China  
an Historical Perspective and its impact on the political system**

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by

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At the eve of the economic reform in 1978, China was seen to be shackled by its thousand-year-old bureaucracy which, whilst guaranteeing longevity and territorial integrity through its authoritarian and predatory tendencies<sup>1</sup>, always stifled the emergence of capitalism. In the space of a quarter of a century a thorough-going change has visibly taken place, replacing the vision of a “giant with feet of clay”, imprisoned in its bureaucratic traditions, with a new vision of an emerging economic superpower. The gap between these analyses and the kinds of terms we now use almost daily when speaking of China is all the more striking. China is now “the world’s factory”, “the motor of global economic growth”, “a superpower of the twenty-first century” and commercial conflict on textile and exchange rate all demonstrates how important China has become in the world economy. After repeated attempts since the Opium War of 1842, China seems, under the direction of its Communist party, now at last in the process of installing a capitalist system and of permanently reversing the extraordinary economic decline the country witnessed on the world’s stage between 1850 and 1978.<sup>2</sup>

Hence a series of questions inspired by the historic meaning of the economic changes which have taken place in China since in December 1978 when economic reform were officially launched by Deng Xiaoping.

The first question we will try to answer is why a Communist Party who rejected all forms of market economy during its first 30 years of power is succeeding in establishing capitalism in China when so many attempts failed since the mid of the 19<sup>th</sup> Century. Instead of relying on the traditional economic explanation based on labour, capital and productivity favoured by economists and which are now quite well analysed in the economic literature, we will focus more on the political and social factors that explain this acceleration of history?

The second question is related to the different problems that the Chinese economy is facing today. China has registered one of the fastest economic growth in the history of

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<sup>1</sup> “The Chinese State, despite the local complicity of corrupt merchants and mandarins, has always been hostile to the development of capitalism. Every time that it appears, under certain favourable circumstance, it ends up by being brought to heel by a state of a totalitarian character” in F. Braudel, *La dynamique du capitalisme*, Paris, Flammarion, 1985, pp. 121 pp., p. 76. This type of analysis can also be found in E. Balazs, *La bureaucratie céleste*, Paris, Gallimard, 1968, pp., or in M.-C. Bergère, *Le Mandarin et le comprador. Les enjeux de la crise en Asie Orientale*, Paris, Hachette, 1998, 254 pp. pp.

<sup>2</sup> A. Maddison, *Explaining the Economic Performance of Nations*, Cheltenham, Edward Elgar, 1995, 496 pp. pp.

capitalism but this take-off still appears in many analysis, fragile, sometime reversible in front of these problems. Again if we consider what has been achieved during 25 years of reform, the question we can ask is whether these problems represent a real threat for the economic modernisation launched in 1978, and for the definitive establishment of a capitalism system in China?

Finally, a third question that has been repeated like a mantra in foreign government circles and reformers in China is to know whether the economic transformations that have occurred over the past twenty-five years will soon lead to the emergence of a democratic regime and will enable China to complete its cycle of modernisation?

## **I - The Socio and Political Dynamics of the Economic “Take-off”**

In looking for explanations for this spectacular economic take-off over the last twenty-five years, it is possible to limit the search to purely economic factors. For example, the effects of the market’s “invisible hand” which, as Adam Smith pointed out, if it is not disturbed by mankind’s folly (wars, political instability), can lead to economic development even without political liberties and can even operate in the face of erroneous decisions in economic policies.<sup>3</sup> In the same register, it is also possible to evoke growth theories. China seems to be in a slightly more favourable situation compared to other Asian countries, but Chinese growth has also depended, to between 75% and 85% according to estimates,<sup>4</sup> on the contribution of labour and capital. Productivity increase has become significant only since the late 1990’s.

These explanations are well documented in the economic literature and are crucial to understand China’s economic take-off. But they are too narrowly focusing on economic factors and fail to capture other important factors which explain why the China of this last quarter of a century has seen such an acceleration of history and why it did not happen before despite so many attempts since the middle of the 19<sup>th</sup> Century. From this point of view, historians such as F. Braudel,<sup>5</sup> E. Hobsbawm,<sup>6</sup> D. Landes,<sup>7</sup> C. M. Cipolla<sup>8</sup> or J. Baechler,<sup>9</sup> to name only a few, offer a more stimulating theoretical framework. Developments of a capitalistic type are “unthinkable without the complicity of society” tells us F. Braudel (...); they represent “a reality of a social order, (...) a political order, or even a reality of civilisation.”<sup>10</sup> The emergence of capitalism is not to be stated in terms of culture, as M. Weber thought, but rather in terms of the social and political obstacles which capitalism has difficulty in surmounting. Capitalism also puts existing political hierarchies to its own use and transforms them “to reconstruct other hierarchies for its own benefit, which are just as solid and long-lasting.”<sup>11</sup> More precisely, the differences in the progress of reforms in various socialist countries all reveal the influence of certain political and social obstacles, such as

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<sup>3</sup> See the interpretation of A. O. Hirschman, *The Passions and the Interests. Political Arguments for Capitalism before its Triumph*, Princeton, Princeton University Press, 1977, 153 pp. pp.

<sup>4</sup> Yan, W and Yao, Y (2001), *Sources of China’s Economic Growth, 1952-1999: Incorporating Human Capital Accumulation*: Washington D. C., The World Bank.

<sup>5</sup> F. Braudel, *Civilisation matérielle, économie et capitalisme, XVe-XVIIIe siècle*, Paris, Armand Colin, 1979, pp.

<sup>6</sup> E. Hobsbawm, *The Age of Revolution 1789-1848*, London, Vintage, 1962, 356 pp. pp.

<sup>7</sup> D. S. Landes, *The Wealth and Poverty of Nations*, New York, W.W. Norton & Company, 1998, 650 pp. pp.

<sup>8</sup> C. M. Cipolla, *Tra due culture. Introduzione alla storia economica*, Bologna, Il Molino, 1988, pp.

<sup>9</sup> J. Baechler, *Le capitalisme*, Paris, Gallimard, 1995, 889 pp.

<sup>10</sup> F. Braudel (1985), *op.cit*, p. 67.

<sup>11</sup> *Ibid*, p. 74.

coalitions between social groups which, according to their respective power, support or block the emergence of the mechanisms and institutions of a capitalist economy.<sup>12</sup> In light of these theories, it is possible to identify several factors that have come together over the last twenty-five years in China to encourage the development of capitalism.

### *1- Looking for a new political legitimacy with economic reform*

In 1978, the CCP had a few options but to reform its economy. It could have chosen a Brejnev style economic status quo with a return to an orthodox soviet style planning system. Indeed, in 1978, the reformers brought in by Chen Yun sought first to de-politicise businesses and to re-establish the bureaucratic channels of decision-making in the socialist economy, channels which had been totally disrupted during the Cultural Revolution. The elements of flexibility and autonomy that the reformers introduced were intended to give producers more responsibility; they were not designed to break down the socialist system. Reforms in agriculture and in the southern province of Guangdong with some geographically restricted experiment of capitalism in the Special Economic Zones were not extended to the core of the socialist system in urban areas.

However, from 1984 on, the reforms went beyond the control of the more conservative reformers. The political authorities were to find themselves trapped in a dialectic from which they could no longer escape: to enact reforms both in order to correct the contradictions of earlier reforms that might de-stabilise their power, and to generate enough growth to maintain a minimum of political legitimacy in the eyes of the population.

Economically and politically, immobility was no longer an option. Capitalism represented the only possible alternative in terms of organising the economic system. The most reform-oriented fringe of the Party, working with the First Secretary of the time, Zhao Ziyang, used this as a lever against the more conservative old guard. With each wave of reform, the deregulation of the economy (and with it, the greater freedom of individuals and firms in the economy) was ever vaster in scale. The last reform to date, when China joined the WTO in 2001, is in keeping with this logic.

### *2 - The unintentional consequences of Maoist heritage*

Without any doubt, the policies pursued by Mao weighed heavily on the stagnation of the Chinese economy between 1949 and 1978 and even on a decline in some sectors compared to what was happening in its East Asian neighbours. The China Deng Xiaoping inherited in 1978 had been drained of all vitality from an economic point of view, but, paradoxically, it benefited from a certain number of advantages, most of them created unintentionally by Mao's policy.

First compared to the Soviet Union, it had only experienced twenty-five years of the socialist system on its territory. Furthermore, the development of this system was incomplete, either because of Mao's explicit choice to not follow slavishly the Soviet model of hyper-centralised planning, or because the consequences of the Great Leap Forward and the Cultural Revolution had dismantled the structure of the economy's bureaucracy. Several authors, like

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<sup>12</sup> A. Shleifer and D. Treisman, *Without a map. Political tactics and Economical Reform in Russia*, Cambridge, Massachusetts, MIT, 2001, 223 pp. pp.

D. Granick<sup>13</sup> for urban State-Owned and collective enterprises or L. White<sup>14</sup> for small-scale industries in rural area, have shown at the eve of the reform process the existence of differences with the Soviet economic system and of bottom-up forces ready to engage in a more market economy oriented system. This situation of “half-anarchy, half-planning”<sup>15</sup> which characterised the running of the Chinese economy in 1978, along with its agricultural base, was to allow for more rapid reform, without having to pay transition costs as high as those in the Soviet Union.

Moreover, in 1978, China disposed of an enormous surplus of rural labour created by the natalist policy decided by Mao in the end of the 1950's. Again Mao's policy created unintentional consequences on the labour market: between 150 and 200 millions surplus active population in the agriculture capable of feeding labour-intensive industrialisation. The population pressure in the countryside represented an indirect but powerful political pressure on the government to introduce reforms in the rural area including the possibility to create Township and Village enterprises.

We can also considered the impact of the “*xiexiang*” policy decided by Mao in 1968 who decided to send 17 millions young educated urban people to the countryside. M. Bonnin has shown in a recent book<sup>16</sup> how this idealistic policy had a result totally opposed to its objectives of pushing the young urban generation to continue the revolution. Confronted to the harsh reality of the countryside life, this generation which contributed at different level of the reform process in the 1980's and 90's, became pragmatic, rejecting all form of ideology. They were definitively less trained in modern economics in other former socialist countries in Europe or in USSR but given their experience in the countryside they were very well aware of the realities of China.

More generally speaking Marxism and Maoism, again paradoxically, have to a certain extent acted like the utilitarianism at the end of the 18<sup>th</sup> century in Europe as “the sharpest of radical axes to chop down traditional institutions”<sup>17</sup> in religion, the State but also in the realm of philosophy and values, which were preventing the rise of capitalism before 1949. Using state violence, in his quest for establishing communism, Mao's policy eradicated most salient part of tradition and anti-modernism. Even if it was far from creating a “blank page” on which capitalism could grow, when communism ideology was abandoned in the economic realm to the profit of pragmatism supported by Deng Xiaoping, the resurgence of some traditional values in some part of the social life offered little resistance to the rise of capitalism.

### *3 - Co-optation and repression: corporatism with Chinese characteristic*

According to requirements – the needs of reform or conflicts within the Party – the Communist leaders have been prepared to co-opt certain blocs of society, as long as these blocs did not represent a threat to their monopoly of power.<sup>18</sup> This corporatist strategy, whilst

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<sup>13</sup> D. Granick, *Chinese State Enterprises*, Chicago, University of Chicago Press, 1990, pp.

<sup>14</sup> L. T. White III, *Unstately Power. Volume I : Local Causes of China's Economic Reforms*, Armonk, M. E. Sharpe, 1998, 521 pp. pp.

<sup>15</sup> In 1978, only 600 products were subject to centralised planning, compared to 60,000 in the Soviet Union; see B. Naughton, *Growing out of the Plan Chinese Economic Reform 1978 -1993*, Cambridge, Cambridge University Press, 1995, 379 pp.p. 43.

<sup>16</sup> M. Bonnin, *Génération perdue*, Paris, Editions EHESS, 2004, 491 pp.

<sup>17</sup> Hobsbawm, E (1962), p. 236.

<sup>18</sup> J.-P. Béja, *A la recherche d'une ombre chinoise*, Paris, Seuil, 2004, 262 p. pp.

appropriate to the necessities of the Chinese economy, was largely copied from other authoritarian regimes.<sup>19</sup> During the 1980s, Deng Xiaoping was to deregulate certain sectors of the economy to win the support of the peasants, the authorities in the coastal provinces, the members of the Party and bureaucrats at all levels of the administration in charge of the management of the economy, as well as the directors of State firms.<sup>20</sup> This coalition of interests would easily fulfil its functions in the realm of economic growth and would also enable each group to increase its revenues.

Between 1989 and 1991, however, the return to power of the conservative fringe of the Party, following the massacre at Tiananmen Square, led to a break-up of this coalition and a period of retrenchment during which the Party withdrew to rely on its own forces. It tried to re-impose socialist orthodoxy in the management of the economy but without success since the reforms had already created too many irreversible capitalistic mechanisms.

Furthermore, economic problems resulting from the reforms were starting to accumulate: a decline in growth, unemployment, corruption, the State-run firms in debt, and the increase of bad debts in the banking sector. These forced the Jiang Zemin-Zhu Rongji tandem to establish a coalition based on new blocs.

The bureaucrats and directors of the State-owned enterprises were still part of the coalition, joined first by intellectual experts, then by foreign investors, and then, later, and only gradually, by private entrepreneurs. As Huang Yasheng remarks,<sup>21</sup> a major novelty is to be noted here, compared to Japan or South Korea (the main references where Chinese economic development is concerned): for a long time the Party has preferred foreign investors to indigenous private entrepreneurs, for fear that the economic power of the latter would become political influence.

This coalition, still in power today, has been active in the solution of certain economic problems whilst reaping advantages in terms of income. The reinforcement of the economic institutions that accompany capitalism has benefited from the support of the intellectual experts.<sup>22</sup> Foreign investors have brought growth, currency and commercial outlets abroad in exchange for fiscal advantages and access to rural labour. Private entrepreneurs have made their contribution to growth in exchange for a consolidation of their property rights. The reform of the public sector has enjoyed the support of the bureaucrats, of the directors of the State-owned companies and of private entrepreneurs. In exchange these last have profited from privatisation campaigns, acquiring assets at remarkably low prices.

No other communist power has ever been quite so far in pursuit of a corporatist strategy. Caught between the necessity to support growth and the will to maintain the Party's dictatorship, the Chinese Communist leaders have had to forge coalitions which are entirely different from those existing traditionally in other socialist regimes.

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<sup>19</sup> J. Unger and A. Chan, "Corporatism in China: A Developmental State in an East Asian Context", in B. L. M. Cormick and J. Unger, *China After Socialism, In the Footsteps of Eastern Europe or East Asia*, Armonk, M. E. Sharpe, 1996, pp. 95-129.

<sup>20</sup> S. L. Shirk, *The Political Logic of Economic Reform in China*, Berkeley, University of California Press, 1993, 399 pp.

<sup>21</sup> Y. Huang, *Selling China: Foreign Direct Investment During the Reform Era*, Cambridge, Cambridge University Press, 2003, pp.

<sup>22</sup> Béja (2004), *op.cit*

This corporatism clearly engenders the two types of consequence that are to be seen in other countries which have adopted a similar strategy. First, the difficulty in establishing a State based on laws which can control capitalism; each bloc seeks to profit from the reforms and is reluctant to see the application of legal constraints, preferring to negotiate with the Party to maintain its position, or even to turn legislation to its own particular advantage. Corruption, the accumulation of bad debts, the violation of workers' rights and other manifestations of unfettered capitalism are the direct result of the political dynamics of reform. Secondly, the Chinese leaders have had to continue to use State violence in order to prevent any form of organisation within the blocs or between other blocs excluded from the coalition, seeking to contest the Party's dictatorship or to correct the inequalities engendered by the reforms.<sup>23</sup>

#### *4 - A non ideological macro-economic management*

Along other socio-political factors contributing to explain this long period of growth, it is necessary to mention here that the Communist leaders in China, supported by the experts, have been successful in their piloting of macro-economic policies. With the exception of the domestic debt, the main balances (fiscal deficit, deficit in the balance of current transactions, foreign debts) have never come under threat, at least up to now. China has thus been able to avoid the dramas of inflation which, in many other countries in transition, have undermined the population's support for reform. It has also meant that China has been able to maintain its independence with regards to the international financial community and especially to listen the siren of the "Washington consensus". As J. Stiglitz points out, the Chinese leaders have refused to listen to the various apologists of neo-liberalism who recommended a brutal deregulation of the financial system and of exchange rates. This not only allowed China to escape being swept up by the crisis of other Asian countries in 1997 but also to continue to allocate huge amount of capital for building its infrastructure and modernise its industry.

#### *5 - A favourable regional context*

Lastly, the regional economic context and the existence of an important Chinese community overseas, particularly active in the international division of work, have also turn out to be a precious advantage for China when it decided to open up to the outside world. The exponential development of foreign direct investment in China is also a story of an encounter: a Communist regime who needed technology and capital to reform its urban economy and could provide cheap labour and countries in East Asia (Hong Kong, Taiwan, and to a certain extent South Korea) where price of land and wages were going up very quickly and undermining their competitiveness in the international division of labour. Indeed, most of the trade deficit that these countries had with United States in 1970's and 1980's have been transferred to China along the huge delocalisation of the most labour intensive part of their industrial capacities in Guangdong-Fujian province and Shanghai and its hinterland.

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<sup>23</sup> *ibid*

## II - Current economic problem: a threat for the economic modernisation?

Endemic corruption,<sup>24</sup> accumulation of bad debts in the banking system,<sup>25</sup> illicit acquisition of public assets,<sup>26</sup> growing social unrest due to revenues inequalities, high level of destruction of environmental resources,<sup>27</sup> tax evasion and flight of capital to tax havens<sup>28</sup> are all serious and well documented problem in China. Many economic analysts are seriously questioning the capacity of the Chinese government to overcome these problems, raising at the same time the question of a possible collapse of the economic modernisation which started in 1978, and ultimately representing a serious threat for the survival of the Communist Party.

Before analysing in more details the potential impact of each of these problems two very important evolution which occurred since 1978 need to be emphasised as they are crucial to understand the growing resilience of the Chinese economy to contradiction and economic problems.

### *1 - Leaving socialism behind and irreversibility in the emergence of a capitalist system*

Over the last twenty-five years, the principal instruments governing the management of the socialist economy in China have been abolished. From the beginning of the 1990s, economic planning structures were dismantled in a process characterised by the deregulation of prices, supplies and distribution. The reforms enacted at the beginning of the 1980s, permitting businesses to sell freely on the market any goods that exceeded the quotas fixed by the State Planning Commission gradually led, purely and simply, to the disappearance of the Plan.<sup>29</sup> Today, over 90% of retail prices in industry and 80% of agricultural prices are determined by the market.

Despite endemic problem in the corporate governance system and a politicised decision-making in the banking system, the financial system has been also completely revamped since 1978.

Concerning the evolution of property rights, the last twenty-five years have been marked by a considerable diversification of forms of ownership and by a significant withdrawal of the State. But, for political reasons, this process has been more complicated than in other former socialist countries. Since 1997, however, the discussion has been more open and the directives clearer where the privatising of public companies is concerned, as well as the legal recognition of the private sector. According to recent estimates,<sup>30</sup> between 30,000 and 40,000 small and medium-sized state enterprises in the industrial sector have gone over to the private sector since 1997 (out of a total of 126,000 state firms in the industrial

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<sup>24</sup> Q. He, *Zhongguo de xianjing (China's Pitfall)*, Hong Kong, Mingjing Chubanshe, 1998, 410 pp.

<sup>25</sup> V. Shih, "Dealing with Non-Performing Loans: Political Constraints and Financial Policies in China", in *The China Quarterly*, n° 180, December 2004, pp. 922 - 944.

<sup>26</sup> X. L. Ding, "The Illicit Asset Stripping of Chinese State Firms", in *The China Journal*, n°43, January 2000, pp. 1-28.

<sup>27</sup> Stockholm Environment Institute and UNDP, *Making Green Development a Choice. China Human Development Report 2002*, New York, Oxford University Press, 2002, 150 pp.

<sup>28</sup> X. L. Ding, "Systemic Irregularity and Spontaneous Property Transformation in the Chinese Financial System", in *The China Quarterly*, n°163, September 2000, pp. 665-676.

<sup>29</sup> B. Naughton, (1995), op. cit

<sup>30</sup> J.-F. Huchet, "The Hidden Aspect of Public Sector Reforms in China, State and Collective SMEs in Urban Areas", in *China Perspectives*, n°32, November - December 2000, pp. 37-48.



sector in 1996). The national private sector accounts for almost a quarter of industrial production and, if foreign businesses are included, the private sector represented almost 45% of the country's industrial production in 2002.

We could continue to review the principal mechanisms characteristic of socialist economies to underline just how far the Chinese economy has already left this system behind. The main distortions found in socialist-type economies have also largely disappeared. Whilst agriculture still represents the main activity in terms of employment, the service sector – traditionally under-developed in socialist economies – went from 12% of the total active population in 1978 to almost 32% in 2003.<sup>31</sup> As a consequence of the reforms, the economy has rapidly become monetised. The rate of liquidity (that is to say, the monetary mass as a proportion of the GDP), traditionally very low in socialist economies, rose from 32% in 1980 to 82% in 1990 and to 165% in 2001.<sup>32</sup> From the early 1990s on, the Chinese economy ceased to be dominated by the supply side, or, to use J. Kornai's expression, to be "an economy of shortage". One consequence of this is the development of ferocious competition between domestic Chinese companies.

From all these observations, is it possible to conclude then that China has now accomplished its transition to capitalism? Considering the transitions of other former socialist countries in Eastern Europe or the former Soviet Union, the elements mentioned above all suggest that China has largely solved the worst problems of its transition. If we consider China in the terms of reference used by the World Bank or the European Bank for Reconstruction and Development for measuring progress towards a capitalist economy, it would seem that the country is well to the fore, except where its political regime is concerned and the credibility of its legal system. True, several vital questions linked to its socialist heritage remain to be dealt with, such as the withdrawal of the State from large public companies, the politicisation of the decision-making system in the banking system and the reform of the social protection system. But similar problems are to be found in almost all the former socialist economies, including those that have made most progress in the transition process and which are joining the European Union today. Considering the situation of the Chinese economy in 1978, this represents a silent revolution comparable to the one we have witnessed in Europe since the fall of the Berlin Wall.

But more relevant to our original question, China today has practically abandoned all the instruments once used in the management of a planned economy. Given the fate at the international level of socialism as a system to organise economic life, blocking the emergence of capitalism, (which was still unsure in 1989 after Tiananmen political crisis when conservators brought back socialist orthodoxy during two years), seems now unthinkable.

## *2 - Working for the future: building critical masses in consumption, human capital, and infrastructure*

The duration of the reforms and the economic growth registered in China since 1978 have allowed for the constitution of critical masses in many fields. Although, when trying to measure economic progress, it is always essential to relate statistics to the immensity of the Chinese population as a whole, certain absolute values cannot be ignored.

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<sup>31</sup> *China Statistical Yearbook*, 2004.

<sup>32</sup> Cai, F and Lin Y. (2003), *Zhongguo Jingji* (The Chinese Economy), Beijing, Zhongguo caizheng jingji chubanshe, p. 74.

Despite the continued existence of important pockets of regional protectionism, a national market has been created. It is based on the consumption patterns of a population which is now largely urban and which varies, according to estimates, from 150 to 200 million individuals. This population is now reckoned to have adequate disposable income to meet needs for food, clothing, household appliances, education, and, more recently, and with the help of bank loans, to envisage home ownership and the acquisition of other material possessions of even greater value. The figures are still a far cry from certain Western dreams of a market of 1.3 billion consumers, but with this middle-class population growing by 5 to 10 million per year, this market is undeniably an important motor for future Chinese economic growth.

With 60 billion dollars invested in research and development in 2001, that is to say 1.01% of its GDP, China now occupies the third position in the world on this count, behind the United States (282 billion dollars) and Japan (104 billion dollars), but ahead of Germany (54 billion dollars).<sup>33</sup> In 2002, China trained nearly 459,000 new engineers (four times more than in France) and 3.2 million new students entered Chinese universities in the same year (twice the total number of students enrolled in French universities). In 1978 these same universities were barely functioning at all after a decade of being practically closed down.<sup>34</sup>

In the past twenty-five years, close to 1.7 million kilometres of new roads has been built, of which 19,000 are motorways. Its rail network grew by 70% during the same period and air transport now carries close to 100 million passengers a year.<sup>35</sup> Despite the very rapid growth of the GDP and occasional shortage, the production of electricity, at 1.4 billion kWh, has grown dramatically compared to 1978. Infrastructures in the telecommunications sector have also exploded over the last twenty-five years, with 250 million mobile phone users (the leading market world-wide), almost as many subscribers on fixed lines and 60 million subscribers to the Internet.

Over the last twenty-five years, China has attracted close to 470 billion dollars in foreign direct investments, that is to say a quarter of the total in foreign investments going to developing countries over the last ten years. These direct foreign investments have enabled China to restructure its foreign trade: firms with foreign capital now represent more than half of all Chinese exports and 30% of the country's industrial production. China now occupies the fifth position amongst the world's commercial powers. Foreign direct investments and surplus in trade balance have allowed China to amass 600 billion dollars in currency reserves in record time. But direct foreign investment has also contributed much more, in terms of technology, management techniques and labour training.

This impressive growth registered since 1978 marks the end of its century-old economic decline, as A. Maddison has demonstrated.<sup>36</sup> In spite of the criticisms levelled at the way China calculates its GDP on a purchasing power parity basis, the Chinese economy nonetheless figures today among the five leading economies of the planet, to an extent that its growth now influences the prices of raw materials on the world market. Despite all the shady areas in the statistics and the highly unequal character of growth this last quarter of a century of transformation of the Chinese economy is certainly worthy of comparison, in capitalism's

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<sup>33</sup> OECD figures, quoted by the *Financial Times*, 26th October 2003.

<sup>34</sup> *Ministry of Science and Technology Data Book*, 2003.

<sup>35</sup> *China Hand*, Economist Intelligence Unit, December 2002.

<sup>36</sup> A. Maddison (1995), *op.cit.*

long-term history, with the way the American and Japanese economies caught up with those of the European powers, and, in doing so, completely modified the world's economic hierarchies.

Coming back to the question of potential consequences of all the current problems of the Chinese economy on the modernisation quest that started in 1978, these critical masses attained over the last quarter of a century help China to be much more resistant to minor and localised crises (banking, some industrial sectors, difficulties in one region due to restructuring).

### *3 - So far the Communist Party is Managing the problems but for how long?*

Problems in the Chinese economy are largely the result of the political dynamics of reform, as we have seen above. The Party has been so far able to maintain these phenomena at levels that do not endanger the broader macro-economic balances of the country.

Growth is stimulated by the broadening base of mass consumption, by the robustness of external trade and by very high level of investment programmes financed by the State and more recently by the private sector. The existence of an enormous treasure hoard in the form of 600 billion dollars in foreign currency, and household savings representing 40% of the GDP, will help prevent macro-economic unbalance resulting from the re-capitalisation of the banking sector. In the hypothesis of a massive re-capitalisation of the banking sector in order to balance liabilities of the four main State banks – the equivalent of 300 to 400 billion dollars according to some estimates,<sup>37</sup> – the public debt would increase considerably but would nonetheless remain below the level of 100% of China's GDP (Japan's being close to 140%). As a last resort, the State could decide to close the banks for a certain time if there was a movement of panic amongst domestic savers. Even the opening of the domestic market for foreign banks planned in the WTO agreement and which will take place in 2006, will not represent a real danger before years for domestic State banks. None of the foreign banks will be able to compete with domestic bank given the size of the investment necessary to build a retail network comparable to Chinese State Banks and the possibility to find and train so many employees. Moreover, the Chinese government will make sure to keep at bay the foreign players through different non-tariff barriers if they become too dangerous for domestic players.

The arrears in the payment of pension, estimated at nearly 200 billion dollars, have been treated with the cynical simplicity of an authoritarian state patiently waiting for its old-age pensioners to die out, a problem which in any developed country would probably cause a revolution. Only 110 million people (a third of the urban population) is somehow covered by the new pension system. But with the rapid aging population which will accelerate after 2015, China will be "become old before becoming a rich country", a phenomenon unseen in history of capitalism. That means that in ten years this cynical attitude will be impossible to maintain and the government will have to face this situation with an efficient pension system.

As for the questions of unemployment and growing inequalities in terms of income, China, over the last twenty-five years, has joined the select group of countries with the highest levels of social inequality. Here again, the State and the Party have demonstrated so far a

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<sup>37</sup> OECD, *China in the World Economy. The Domestic Policy Challenges*, Paris, OECD, 2002, 813 pp.

remarkable capacities to adapt and circumscribe seats of unrest. The Chinese government has relied on a policy of “Carrot and Stick” to check any efforts to organise labour or peasants movements and despite growing numbers of demonstration, sometime very violent, no independent labour unions or alternative political force have been able so far to emerge from these social movements. This strategy will work until the Party will be united, as it has been the case since 1989 after the Tiananmen massacre. But today, if a political dissension would appear at the top of the Party, the social situation would be much more explosive than in 1989.

As far the environment is concerned, it could be paradoxically the greatest threat for the future economic growth. A “business as usual” strategy would accelerate the destruction of the environment up to a point that pollution and scarcity of resources (air, water, energy) could have a serious impact on the economic growth. Nevertheless, despite the severity of the situation, assuming that nothing would be done to correct this evolution, it would be decades before the impact would stop economic growth. Furthermore, the government has started to react through ambitious program of water conservation, reforestation, air pollution control, investment in renewable energy, and of public awareness promotion in favour of environment. These initiatives are still far from changing the overall situation but again we can assume that the government will not let the situation to deteriorate up to a level that could threaten the economic growth. Concerning its current impact on the political system, contestation movements related to environment problems are treated by the government like social unrest, well circumscribed, and do not seem to represent any threat for the regime.

After so many attempts since the mid 18<sup>th</sup> century, a capitalist type economic take-off has apparently succeeded. Scenario of chaos that have emerged periodically in different analysis during these twenty-five years of reforms and which predict a deep economic crisis caused by contradiction in the reforms process, have not happened.<sup>38</sup> China is facing serious problems but none of them taken separately seems severe enough to make the economic modernisation process leave the rails durably. Critical masses accumulated since 1978 in infrastructure, human capital, domestic consumption, industrial know-how, external trade seems to protect the Chinese economy against a crisis like in Argentina, which have blocked its economic development for decades. China is like a giant dragging several heavy weights, but it has developed sufficient strengths since 1978 to keep running.

This is not to say that China is not immune against an economic crisis caused by internal problems like history of all economic superpower has shown. Indeed, nobody can really say what will happen if an external shock combined with a political dissention at the top of the Party like in 1989 would cause on the economic situation. In such condition all internal problem that seems so far under control could merge, and China would face a serious economic crisis. Nevertheless by definition this type of combination of factors is very difficult to predict.

### **III - Economic Modernisation and the Pursuit of a Political Status Quo**

The last question we raised in the introduction is whether these profound economic changes that are leading, day by day, to a progressive liberalisation of the economic sphere

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<sup>38</sup> G. G. Chan, *The Coming Collapse of China*, New York, Random House, 2001, 344 pp. pp.

will force the Chinese Communist Party to implement or to accept political reforms leading to the emergence of a democratic regime.

There are no doubts that the economic take-off had an important impact on the political regime. In order to deliver growth and to solve contradiction surging in the path of reform, the Chinese Communist Party had to implement economic liberalisation (competition, privatisation, financial reform) but also to reform its method of intervention, not only in the economy but also in many aspect of the society. This dialectic evolution has led the Chinese political system to mute from a totalitarian regime towards an authoritarian one. It has created new space of freedom in China, some of them probably unthinkable 25 years ago, but as far as democratisation of the regime is concerned there is still a long way to go.

Economic factors are pivotal in democratisation process of developing countries. Nevertheless outside the general theory put forward by S.M. Lipset in 1959<sup>39</sup>, which state that developed countries tend more often to be democratically organised, there is no indication on the level of GDP per capita a middle-income country should reach to become democratic. The multiplicity of political situations in developing countries and the history of capitalism in Europe in the 18<sup>th</sup> and 19<sup>th</sup> century both show that there are no hard rules on this point. This is not to say that the political sphere is in a situation of complete autonomy with regards the economic sphere, but rather, as A. O. Hirschman observes, that the two spheres have a relation “of coupling and separation, or an alternation between moments of inter-dependence and autonomy.”<sup>40</sup> The literature which has analysed different transition from authoritarian regime to democracy in middle-income countries<sup>41</sup> emphasize the fact that economic crisis are often a crucial factor which speed up the evolution. It makes social groups supporting authoritarian regime, change their mind and induce them to join other groups pushing for a democratic evolution. It is true for the private entrepreneurs which can have a great influence on investment, employment, and financial flows as well as middle-class and white collars whose support and expertise in running the economy and the bureaucracy are crucial for the survival of an authoritarian regime. Obviously, the capacity of blue collars workers and peasants to organise themselves in independent and strong institution is also crucial for pushing an authoritarian regime to accept a democratisation.

Coming back to the case of China, there are very few factors in the current economic situation likely to lead to a democratic evolution of the regime. As we have seen in the previous section, economic fundamentals in China are sound, especially the level of external debt which is very low compared to international standard and the continuing current account surplus that makes China one of the main creditors of the world with Japan. These two factors protect China from an external debt crisis that forced developing countries to implement socially painful adjustment program, or to use inflation as a temporary solution (or most of the time, both). These two policies are often triggering strong social and political reaction from groups supporting authoritarian regimes and lead them to support democratic forces.

Another factor that tends to favour a statu-quo in China is the attitude of the private sector. Growth and competitiveness relies today on the perpetuation of considerable social

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<sup>39</sup> S. M. Lipset, "Some Social Requisites of Democracy: Economic Development and Political Legitimacy", in *American Political Science Review*, n°53, pp. 69-105.

<sup>40</sup> A. O. Hirschman, *A Propensity to Self-Subversion*, Cambridge, Massachusetts, Harvard University Press, 1995, 262 p. pp.

<sup>41</sup> See for example S. Haggard and R. R. Kaufman, *The Political Economy of Democratic Transitions*, Princeton, Princeton University Press, 1995, 391 pp. pp.

inequalities, particularly for China's rural labour force. Given the demographic transition which is already leading to shortage of cheap labour coming from the countryside, the private sector does not have any advantages in supporting a democratic transition that will bring more social rights. Moreover, despite the growing importance of the private sector in China, private firms are relatively small compared to other developing countries like in former authoritarian regime like South Korea, Indonesia, Brazil, Argentina or even India during the suspension of democratic rights between 1977 and 1979.<sup>42</sup> The public sector is still the dominant player in every corner of the urban economy. Nearly 60% of labour in urban areas is still in the public sector, and most of the financial resources of the country are in the hand of State-Owned Banks. This means that in case of a crisis or of a lower growth rate, the State can still influence positively the economy (and it has used this strategy in 1997 during the Asian crisis) and reduce the impact of a potential exit of the private entrepreneurs from the coalition supporting the regime. State has also demonstrated on various occasion its ability to jail private entrepreneurs for being outspoken on political rights. It is still difficult to assess what will be the impact of Jiang Zemin decision's to allow private entrepreneurs to join (or to stay in case of former managers after privatisation of former State-Owned enterprises) the Chinese Communist Party. But so far, as B. Dickson shows in a recent study, private entrepreneurs still remain to a large extent in a "non-critical sphere".<sup>43</sup> This attitude though, does not tell us what could do the private sector in case of a crisis. The literature on South American democratic transition<sup>44</sup> shows that private entrepreneurs are usually non confrontational when economic situation is good but can change very quickly their support in case of a crisis if they think that authoritarian regime is not able to manage the economy anymore. But again for China, their capacity to dissent and the impact of a potential exit would probably be limited given the grip of the Party is maintaining on any organisation (including within its ranks), the financial weakness of private enterprises, and the importance of the Public sector in the national economy.

As far as the emerging middle class in urban areas and white collars are concerned, the steady growth of their revenue since the beginning of the reform make them supportive of the regime despite an endemic corruption and its arbitrary rules. The memory of the turmoil caused by the Cultural Revolution is still very vivid and the argument repeated by the Communist Party which consider democratisation a premature and risky adventure, is widely accepted among them. Nevertheless, like the private entrepreneurs their current supportive or non confrontational attitude for the regime during time of growth give us no indications on a potential evolution or exit from the coalition in time of crisis. The literature on the political economy of transition tells us that this potential evolution in period of crisis depends on the capacity of the government to offer some compensation through salary rise, stability of energy prices, or public investment program.<sup>45</sup> At first sight, as we have seen previously there are no signs of a deep economic crisis looming ahead in China in the short and mid-term but the volatility of support for authoritarian regime by groups like private entrepreneurs, middle-class or white collars is probably receiving a lot of attention by the Chinese Communist Party.

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<sup>42</sup> See D. Rodrik and A. Subramanian, *From "Hindu Growth" to productivity Surge: The Mystery of the Indian Growth Transition*, Washington D.C., International Monetary Fund, 2004, 43 pp. on the change of attitude of Indira Ghandi toward the private sector in the beginning of 1980's after her decision to suppress democratic rights between 1977 and 1979.

<sup>43</sup> B. J. Dickson, *Red Capitalists In China. The Party, Private Entrepreneurs and Prospect for Political Change*, Cambridge, Cambridge University Press, 2003, 187 pp. pp.

<sup>44</sup> J. Frieden, *Debt, Development and Democracy*, Princeton, Princeton University, 1991, pp.

<sup>45</sup> S. Haggard and R. Kaufman (1995), *op. cit.*

Concerning the working class in urban areas who have been hit by the restructuring of the industrial sector in public companies or the peasants, the government has applied a well designed “carrot and stick” policy. For “carrot”, a two digits growth limits the impact of restructuring by providing employment for former State-Owned companies employees in the private sector or in services (even if big part of these jobs are precarious)<sup>46</sup>, and supplementary revenues for peasants who are migrating to cities during short periods of time. In rural area, for the first time in China’s history, this kind of revenues have exceeded revenues coming from agriculture activities. More recently, the new tandem, Hu Jingtao and Wen Jiabao have also launched a series of measures in favour of rural areas like exemption of education fees for children in poor areas, limitation of local (and non official) taxes, and support of agriculture prices. These measures are also instrumental to consolidate their power in front of former Party Secretary Jiang Zemin and his allies, but they show also the necessity for an authoritarian regime to use other means than repression to reduce social tensions. For the “stick”, the Communist Party has been able to suppress any attempts to form independent labour unions and political parties. It is probably in this area that we find the greatest continuity with the former socialist totalitarian regime and it makes a big difference with other former authoritarian regimes in developing countries as most of them had either experienced democracy in the past or authorized under strict control, the existence of political parties or independent labour unions.

Concerning foreign pressure, no any real initiative is to be expected. Foreign investors are using coastal provinces as their “world factory” and are trying to secure a part of the “market of the century”; foreign government on their side are maintaining behind declaration of principles on democratisation have renounced to support democratic forces and their diplomacy is mainly dominated by trade issues. On this point, the situation in China is again very different to what happen in former authoritarian countries like Philippines, South Korea, Taiwan, Indonesia, Turkey, Chile, Brazil, Argentina or Easter Europe countries where United States and to a lesser extent Western European Countries after supporting these regimes decided in the 1980’s to back a democratic transition.

In short, the coalition of blocs led by the Party tends to favour the continued existence of the political status quo and nothing suggests that one or several of the blocs comprising the present coalition are willing to risk losing their advantages in a conflict with the Party in time of rapid growth. In this context, the expansion of capitalism in China at best brings some form of protection against the arbitrary blows of authority, of which Montesquieu spoke, and which Chinese society has been a victim of since 1949, but in no way represents a promise for the democratisation of the regime. The economic take-off and the establishment of capitalism have brought many new spaces of freedom in the social life for Chinese citizens. These new spaces of freedom are playing in the long run quietly in favour of democracy. But as long as the economic situation does not create some conflicts among the top leaders, the Chinese Communist Party will have a great control on the speed and the degree of democratisation.

## Conclusion

The last quarter of a century is a period of considerable importance in China’s modern history. Not since the Opium War of 1842 has the country witnessed such a lengthy and intense period of economic “take-off”. The process of transition towards a capitalist system is

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<sup>46</sup> D. J. Solinger, "Chinese Urban Jobs and the WTO", in *The China Journal*, n°49, January 2003, pp. pp. 61-87.

well advanced today and seems irreversible despite many contradiction and deep problem in the economic system. The constitution of critical masses in domestic consumption, in human resources and in infrastructural elements, by their cumulative impact, now give China a solid base for the pursuit of its economic development but many problems like in the pension and the banking system, the governance of the State-owned enterprises, the social inequalities and the level of environment destruction will need to be addressed if China wants to maintain a steady economic growth.

Ironically, capitalism has emerged as the only alternative for the Chinese Communist Party if it wants to remain in power. The Chinese Communist Party has also largely succeeded in harnessing capitalism. In exchange for the perpetuation of its own dictatorship, capitalism offers different sectors of society a minimum political pact, based on the possibilities of personal enrichment and the development of economic power corresponding with the nationalistic aspirations of the elite and much of the population as a whole. There are many similarities with other authoritarian regimes which have had recourse to corporatism in order to underpin economic development, but with one major economic difference: the Chinese Communist Party has opened the doors wide to foreign investors, who, for their part, have not hesitated to profit from the social inequalities within the population to feed their networks of international production. Whether this is a sign of the regime's incapacity to promote technological progress, a distrust of domestic capital or a new constraint imposed by globalisation on the catching-up strategies of developing countries, the result is there: a considerable opening up of the Chinese economy, the opposite from the mercantilist strategies seen in Europe, the United States, Japan or South Korea at comparable stages of development.

The obstinacy with which the Communist authorities use semantic pirouettes and recourse to violence in order to pursue economic modernisation nonetheless appears increasingly pointless and counter-productive today. First of all, many of China's economic problems are, precisely, the result of the refusal to permit the emergence of real counter-powers within society. Secondly, this last quarter of a century has witnessed an intellectual evolution in China, accompanied by scientific, economic and social evolutions, which allow us to imagine a progressive evolution towards democracy. Indeed everything now seems to be in place for this evolution: the different currents within the Party and within the institutions at the helm of the capitalist economy, as well as rising standards of living and better education of the population. Moreover, The Chinese Communist Party will still have in a scenario of democratisation during a period of growth, the possibility to negotiate on its own terms the pace of the democratic reform, its place on the new political spectrum, and to keep a grip on the public assets like in the case of Taiwan or Chile. The transformations to be seen today might indeed allow China to progress with serenity towards the "fifth modernisation" inscribed by the dissident Wei Jingsheng on the 1979 "wall of democracy" and to close the long path followed for nearly a century to enter modernity.