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# **The Emergence of Capitalism in China: An Historical Perspective and Its Impact on the Political System**

ON THE EVE OF THE LAUNCH OF ITS ECONOMIC REFORM PROGRAM IN 1978, China was seen as shackled by its thousand-year-old bureaucracy—a bureaucracy that, while guaranteeing longevity and territorial integrity through its authoritarian and predatory tendencies, always stifled the emergence of capitalism (Braudel, 1985: 76).<sup>1</sup> In the space of a quarter of a century, a thoroughgoing change visibly took 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 engine of global economic growth,” “a twenty-first-century superpower.” Moreover, commercial conflicts over textiles and exchange rates demonstrate how important China has become to the world economy. After repeated attempts since the 1842 Opium War, China seems, under the direction of its Communist Party, to be at last in the process of installing a capitalist system and of permanently reversing the extraordinary economic decline the country witnessed between 1850 and 1978 (Maddison, 1995).

This leads to a series of questions inspired by the historic meaning of the economic changes that have taken place in China since December 1978, when economic reform were officially launched by China's paramount leader, Deng Xiaoping.

The first question we will try to answer is how did a Communist Party that rejected all forms of a market economy during its first 30 years in power succeed in establishing capitalism in China when so many attempts had failed after the mid-nineteenth century. Instead of relying on the traditional economic explanation based on labor, capital, and productivity that is favored by economists and that has been well discussed 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 faces today. China has registered one of the fastest economic growth rates in the history of capitalism, but this take-off still appears fragile in many analyses, potentially reversible. Again, if we consider what has been achieved during 25 years of reform, the question we can ask is whether the problems that create the concern with fragility represent a real threat to the economic modernization launched in 1978, and to 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 by reformers in China: Will the economic transformations that have taken place in the People's Republic soon lead to the emergence of a democratic regime that will enable China to complete its cycle of modernization?

## **I. THE SOCIOPOLITICAL DYNAMICS OF THE ECONOMIC TAKE-OFF**

In looking for explanations for China's spectacular economic take-off, it is possible to limit the search to purely economic factors. For example, the effects of the market's "invisible hand," if it is not disturbed by mankind's folly (wars, political instability), can lead, as Adam Smith

pointed out, to economic development even without political liberties and can even operate in the face of erroneous decisions in economic policies (Hirschman, 1977). In the same register, it is also possible to evoke growth theories. China seems to be in a slightly more favorable situation compared to other Asian countries, but Chinese growth has also depended—between 75 percent and 85 percent, according to estimates (Yan and Yao, 2001)—on the contribution of labor and capital. Productivity increase has become significant only since the late 1990s.

These explanations are well documented in the economic literature and are crucial to understanding China's economic take-off. But they focus too narrowly on economic factors and fail to capture other important factors that explain why China has seen such an acceleration of history and why it did not happen before, despite so many attempts since the mid-nineteenth century. From this point of view, historians such as F. Braudel, E. Hobsbawm, D. Landes, C. M. Cipolla, or J. Baechler, to name only a few, offer a more stimulating theoretical framework. Developments of a capitalistic type are "unthinkable without the complicity of society" Braudel tells us. They represent "a reality of a social order, . . . a political order, or even a reality of civilisation" (Braudel, 1979: 67). 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 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" (74). More precisely, the differences in the progress of reforms in various socialist countries reveal the influence of certain political and social obstacles, such as coalitions between social groups that, according to their respective power, support or block the emergence of the mechanisms and institutions of a capitalist economy (Shleifer and Treisman, 2001). In light of these theories, it is possible to identify several factors that have come together in China over the last 25 years to encourage the development of capitalism.

### **Looking for New Political Legitimacy with Economic Reform**

In 1978, the Chinese Communist Party came to the realization that it had to reform the Chinese economy. The party could have chosen to maintain the economic status quo with a return to an orthodox Soviet-style planning system. In fact, the reformers recruited by Chen Yun sought first to depoliticize businesses and to reestablish bureaucratic channels of decision making in the socialist economy. These channels, however, had been totally disrupted during the Cultural Revolution. The elements of flexibility and autonomy that the reformers introduced instead 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, along 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 found themselves trapped in a dialectic from which they could no longer escape: to enact reforms both to correct the contradictions of earlier reforms that might destabilize 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 organizing the economic system. The most reform-oriented fringe of the party, working with the general secretary at 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) grew vaster in scale. The last reform to date, when China joined the World Trade Organization (WTO) in 2001, is in keeping with this logic.

### **The Unintentional Consequences of a Maoist Heritage**

The policies pursued by Mao were a major factor in the stagnation of the Chinese economy between 1949 and 1978 and even contributed to a decline in some sectors when compared to what was happening in

China's East Asian neighbors. 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 policies.

First, unlike the Soviet Union, it had experienced only 25 years of a socialist system. Furthermore, the development of this system was incomplete, either because of Mao's explicit choice not to follow slavishly the Soviet model of hypercentralized planning, or because the consequences of the Great Leap Forward and the Cultural Revolution had dismantled the economy's bureaucratic structure. Several authors, such as D. Granick, who has studied urban state-owned and collective enterprises, or L. White, who has looked at small-scale industries in rural areas, have shown the existence of differences with the Soviet economic system and of bottom-up forces ready to engage in a more market economy oriented system on the eve of the reform process. This "half-anarchy, half-planning" (Naughton, 1995: 43),<sup>2</sup> which characterized the Chinese economy in 1978, along with its agricultural base, was to allow for more rapid reform without the high transition costs that afflicted the Soviet Union.

Moreover, in 1978 China had an enormous surplus of rural labor created by the natalist policy put in place by Mao at the end of the 1950s. Again, Mao's policy created unintentional consequences for the labor market: a surplus of between 150 million and 200 million people in the agriculture sector capable of feeding intensive industrialization. The population pressures in the countryside represented an indirect but powerful political pressure on the government to introduce reforms in the rural area, including township and village enterprises.

The impact of Mao's *xiangxiang* policy—the decision by Mao in 1968 to send 17 million young educated urban people to the countryside—also must be taken into consideration. M. Bonnin has shown in a recent book (2004) how this idealistic policy had a result totally opposed to its objectives of pushing the young urban generation to continue the revolution. Confronted by the harsh reality of life in the countryside, this generation, which contributed at different levels to the reform process

in the 1980s and 1990s, became pragmatic, rejecting all form of ideology. The members of this generation had far less training in modern economics as practiced in other former socialist countries in Europe or the Soviet Union, 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 acted like utilitarianism at the end of the eighteenth century in Europe as “the sharpest of radical axes to chop down traditional institutions” (Hobsbawm, 1962: 236). These include not only religion and the state but also a philosophy and values that were preventing the rise of capitalism before 1949. Using state violence in his quest to establish communism, Mao eradicated the most salient parts of tradition and anti-modernism. Although it did not create a “blank slate” from which capitalism could develop, communist ideology, when it was abandoned in the economic realm for the pragmatism supported by Deng Xiaoping, did not give way to a resurgence of traditional values in social life that offered significant resistance to the rise of capitalism.

#### **Co-optation and Repression: Corporatism with Chinese Characteristic**

In response to reform requirements or conflicts in the party, Communist leaders have been prepared to co-opt certain parts of society so long as they did not represent a threat to their monopoly of power (Béja, 2004). This corporatist strategy was largely copied from other authoritarian regimes (Unger and Chan, 1996: 95-129). During the 1980s, Deng Xiaoping deregulated certain sectors of the economy to win the support of the peasants, authorities in the coastal provinces, party bureaucrats in charge of the economy, and directors of state firms (Shirk, 1993). Each group contributed to economic growth while also receiving an increasing share of revenues.

Between 1989 and 1991, 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 relied on its own forces as it tried to reimpose socialist orthodoxy in the management of the economy. This met without success,

however, because 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, growing unemployment and corruption, indebted state-run firms, and increased bad debts in the banking sector. These problems forced the Jiang Zemin–Zhu Rongji leadership 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 economic experts, then by foreign investors, and, later, and only gradually, by private entrepreneurs. As noted by Huang Yasheng (2003), unlike in Japan or South Korea (the main references where Chinese economic development is concerned), the party initially preferred foreign investors to indigenous private entrepreneurs for fear that the economic power of the latter would translate into political influence.

This coalition, still in power today, has been active in the solution of certain economic problems while reaping advantages in terms of income. The reinforcement of the economic institutions that accompany capitalism has benefited from the support of the economic experts (Béja, 2004). Foreign investors have brought growth, currency, and commercial outlets abroad in exchange for fiscal advantages and access to rural labor. 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 bureaucrats, the directors of state-owned companies, and private entrepreneurs. In exchange these last have profited from privatization campaigns, acquiring assets at remarkably low prices.

No other Communist power has ever gone so far in the pursuit of a corporatist strategy. Caught between the need to support growth and the will to maintain the party's dictatorship, the Chinese Communist leaders have had to forge coalitions that are entirely different from those traditionally found in other socialist regimes.

This corporatism has clearly engendered the two kinds of consequences that can be seen in other countries that have adopted a similar

strategy. The first is the difficulty in establishing a state based on laws, which can control capitalism; each bloc seeks to take advantage of the reforms and is reluctant to see the enforcement 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 worker rights, and other manifestations of unfettered capitalism are the direct result of the political dynamics of reform. Second, the Chinese leadership has continued to use state violence to prevent any form of organization within the blocs or among the blocs excluded from the coalition that have sought to contest the party dictatorship or correct the inequalities engendered by the reforms (Béja, 2004).

### **Nonideological Macroeconomic Management**

Another factor that has contributed to China's long period of growth is the success of the Communist leaders, supported by experts, in piloting their macroeconomic policies. With the exception of the domestic debt, the main economic balance sheets (budget, current account, foreign debt) have never come under threat, at least until now. China has thus been able to avoid the drama of inflation, which, in many other countries in transition, has undermined the population's support for reform. It also means that China has been able to maintain its independence with regard to the international financial community and, especially, remain deaf to the sirens of the "Washington consensus." As J. Stiglitz (2002) points out, the Chinese leaders have refused to listen to the various apologists for neoliberalism who recommended a brutal deregulation of the financial system and exchange rates. This has allowed China not only to avoid being swept up by the 1997 Asian financial crisis but also to continue to allocate huge amounts of capital to the building of its infrastructure and the modernization of its industry.

### **A Favorable Regional Context**

The regional economic context and the existence of important Chinese communities overseas, which have been particularly active in the international division of labor, have also turned 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 the story of an encounter: of a Communist regime that needed technology and capital to reform its urban economy and could provide cheap labor for countries in East Asia (Hong Kong, Taiwan, and, to a certain extent, South Korea) where the price of land and wages was escalating quickly, undermining their competitiveness in the international division of labor. Indeed, most of the trade surplus that these countries had with the United States in the 1970s and 1980s has been transferred to China, as have the most labor-intensive elements of their industrial capacities, which have moved to Guangdong and Fujian provinces and Shanghai and its hinterland.

## **II. CURRENT ECONOMIC PROBLEMS: A THREAT TO ECONOMIC MODERNIZATION?**

Endemic corruption (He, 1998), the accumulation of bad debts in the banking system (Shih, 2004: 922-944), the illicit acquisition of public assets (Ding 2000a: 1-28), growing social unrest due to income inequalities, the high-level destruction of environmental resources (Stockholm Environment Institute and UNDP, 2002; Wang, 2002), and tax evasion and capital flight to tax havens (Ding, 2000b, 665-76) are all serious and well-documented problems in the People's Republic. Many analysts are seriously questioning the Chinese government's ability to overcome these problems, raising at the same time the question of a possible collapse of the economic modernization that started in 1978, which ultimately represents a serious threat to the survival of the Communist Party.

Before analyzing in more details the potential impact of each of these problems, two important developments that have occurred since 1978 require emphasis since they are crucial to understand the growing resilience of the Chinese economy to contradiction and the aforementioned problems.

### **The Irreversible Emergence of a Capitalist System**

The last quarter century has seen the abolition of the principal instruments governing the management of the socialist economy in China.

Since the beginning of the 1990s, economic planning structures have been dismantled in a process characterized by the deregulation of prices, supplies, and distribution. The reforms enacted at the beginning of the 1980s, which permitted businesses to sell freely on the market an unrestricted amount of goods that exceeded the quotas fixed by the State Planning Commission, led gradually to the disappearance of the state economic plan (Naughton, 1995). Today, more than 90 percent of retail prices in industry and 80 percent of agricultural prices are determined by the market. And, despite endemic problems in the corporate governance system and politicized decision making in the banking system, the financial system has also been completely revamped since 1978.

The last 25 years have also been marked by a considerable diversification of the 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 so far as the privatization of public companies as well as the legal recognition of the private sector are concerned. According to recent estimates (Huchet, 2000: 37-48), 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 sector in 1996). The national private-sector accounts for almost a quarter of industrial production; if foreign businesses are included, the private sector represented almost 45 percent of the country's industrial production in 2002.

The main distortions found in socialist-type economies have also largely disappeared. Although agriculture still represents the main activity in terms of employment, the service sector—traditionally underdeveloped in socialist economies—grew from 12 percent of the total active population in 1978 to almost 32 percent in 2003 (*China Statistical Yearbook*, 2004). As a result of the reforms, the economy has rapidly become monetized. The rate of liquidity (that is, the monetary mass as a proportion of GDP), traditionally very low in socialist economies, rose from 32 percent in 1980 to 82 percent in 1990 and to 165 percent in 2001 (Cai and Lin, 2003: 74). 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 among domestic Chinese companies.

From all these observations, is it possible to conclude 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 earlier 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 toward a capitalist economy, it would seem that the country is well to the fore, except where its political regime and the credibility of its legal system are concerned. 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 politicization of the decision-making system in the banking system, and the reform of the welfare system. But similar problems are to be found in almost all the former socialist economies, including those that have made the most progress in the transition process and which are joining the European Union today. In light of the state of the Chinese economy in 1978, this represents a silent revolution comparable to the one that has been witnessed in Europe since the fall of the Berlin Wall.

But more relevant to our original question is the fact that China 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 organize economic life, the possibility that the Chinese variant could block the emergence of capitalism—which was still possible in 1989 after the Tiananmen political crisis when conservatives brought back socialist orthodoxy for two years—now seems unthinkable.

### **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 the country to attain a critical mass in

many parts of the economy. 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.

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 that is now largely urban and which varies, according to estimates, from 150 million to 200 million individuals. This population is now reckoned to have adequate disposable income to meet needs for food, clothing, household appliances, and education. Moreover, it can now, with the help of bank loans, 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 million to 10 million per year, it is a market that is undeniably an important engine for future Chinese economic growth.

With \$60 billion invested in research and development in 2001 (equivalent to 1.01 percent of GDP), China ranks third in the world in this area, behind the United States (\$282 billion) and Japan (\$104 billion), but ahead of Germany (\$54 billion) (*Financial Times*, 2003). In 2002, China trained nearly 459,000 new engineers (four times as many as France) while 3.2 million new students entered Chinese universities in the same year (twice the total number of students enrolled in French universities). In 1978, the same universities were barely functioning at all after a decade of being practically closed down (*Ministry of Science and Technology Data Book*, 2003).

In the past 25 years, close to 1.7 million kilometers of new roads have been built, of which 19,000 are freeways. China's rail network grew by 70 percent during the same period and air transport now carries close to 100 million passengers a year ("China Hand," 2002). Despite the very rapid growth in GDP and occasional shortage, the production of electricity, at 1.4 billion kWh, has grown dramatically when compared with figures from 1978. Infrastructure in the telecommunications

sector has also exploded over the last quarter century, with 300 million mobile phone users (the leading market worldwide), almost as many subscribers using fixed lines, and 110 million Internet users.

China has attracted close to \$470 billion in foreign direct investment, or a quarter of the total foreign investments going to developing countries over the last 10 years. This direct foreign investment has enabled China to restructure its foreign trade: firms with foreign capital now represent more than half of all Chinese exports and 30 percent of the country's industrial production. China now ranks fifth among the world's commercial powers in terms of volume of foreign trade. Foreign direct investment and trade balance surpluses have allowed China to amass \$825 billion in currency reserves in record time. But foreign direct investment has also contributed much more, in terms of technology, management techniques, and worker training.

This impressive growth registered since 1978 marks the end of China's century-old economic decline, as A. Maddison has demonstrated (Maddison, 1995). The criticisms of the way China calculates its GDP on a purchasing power parity basis notwithstanding, the Chinese economy 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 the gray areas in the statistics and the highly unequal character of growth, the transformation of the Chinese economy over the last quarter century is certainly worthy of comparison, in capitalism's 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.

### **Managing the Problems—But for How Long?**

The problems found in the Chinese economy are largely the result of the political dynamics of reform, as we have seen. The party has been so far able to maintain these phenomena at levels that do not endanger the broader macroeconomic balances of the country (and the critical masses China has attained over the last quarter of a century help make it much more resistant to minor and localized crises in areas such

as banking, some industrial sectors, and regional difficulties due to restructuring).

Growth is stimulated by the broadening base of mass consumption, by the robustness of external trade, and by the high level of investment financed by the state and more recently by the private sector. The existence of an enormous treasury hoard in the form of \$825 billion in foreign currency reserves, and household savings representing 40 percent of GDP, will help prevent any macroeconomic imbalance resulting from the recapitalization of the banking sector. If a massive recapitalization of the banking sector were undertaken to balance the liabilities of the four main state banks—which would cost the equivalent of \$300 billion to \$400 billion, according to some estimates (OECD, 2002)—the public debt would increase considerably but would nonetheless remain below the level of 100 percent of China's GDP (Japan's is nearly 175 percent). As a last resort, the state could decide to close the banks for a period time if there was a panic among domestic savers. Even the opening of the domestic market to foreign banks—which is called for in the WTO agreement and scheduled to take place in 2007—will not represent a real danger for domestic state banks for some time. No foreign bank will be able to compete with the domestic banks given the size of the investment necessary to build a retail network comparable to that fielded by the Chinese state banks and the time it would take to find and train so many employees. Moreover, the Chinese government will make sure to keep at bay the foreign players through different nontariff barriers if they become too dangerous for domestic players.

The arrears in pension payments, estimated at nearly \$200 billion, have been treated with the cynical simplicity of an authoritarian state patiently waiting for its old-age pensioners to die out, a problem that in any developed country would probably cause a revolution. Only 110 million people (a third of the urban population) are covered by the new pension system. But with the rapidly aging population—which will accelerate after 2015—China will “become old before becoming a rich

country," a phenomenon unseen in the history of capitalism (Jackson and Howe, 2004: 40). This means that in 10 years this cynical attitude will be impossible to maintain and the government will have to establish an efficient pension system.

As for the questions of unemployment and growing income inequality, 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 a remarkable capacity to adapt to and circumscribe unrest. The government has relied on a policy of carrot and stick to check any effort to organize labor or peasant movements and, despite growing numbers of demonstrations, some of which have been violent, no independent labor union or alternative political force has emerged from these social movements. This strategy will work as long as the party is united, as has been the case since the 1989 Tiananmen massacre. But today, if political dissension appeared at the pinnacle of the party, the social situation would be much more explosive than in 1989.

As far as the environment is concerned, it might paradoxically be the greatest threat to 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) might have a serious impact on economic growth. Nevertheless, despite the severity of the situation, and assuming that nothing is done to correct this evolution, it will be decades before the effects stop economic growth. Furthermore, the government has started to react through an ambitious program of water conservation, reforestation, air pollution control, and investment in renewable energy. It has also promoted public awareness of the environment. These initiatives are still far from changing the overall situation but again we can assume that the government will not let the environment deteriorate to a level that could threaten economic growth. Contestation movements related to environmental problems are treated by the government as social unrest, well circumscribed, and do not seem to represent any threat to the regime.

After so many attempts since the mid-eighteenth century, a type of capitalist economic take-off has apparently succeeded. The scenarios postulating chaos that have emerged during the twenty-five years of reform and that predict a deep economic crisis caused by contradictions in the reforms process have not panned out (Chan, 2001). China is facing serious problems but none of them taken separately appears severe enough to permanently derail the economic modernization. Critical masses accumulated since 1978 in infrastructure, human capital, domestic consumption, industrial know-how, and external trade seem to have protected the Chinese economy from the kinds of problems that have afflicted countries like Argentina and that have blocked their economic development for decades. China is like a giant dragging several heavy weights, but it has developed sufficient strength since 1978 to keep moving.

This is not to say that China, like all economic superpowers, is immune from an economic crisis caused by internal problems. Indeed, no one can really say what will happen if an external shock combined with a political struggle at the top of the party like that seen in 1989 would mean for the economy. It is possible that all the domestic problems that seem so far under control could merge, forcing China to face a serious economic crisis. Nevertheless, by definition combination of factors such as these is very difficult to predict.

### **III. ECONOMIC MODERNIZATION AND THE PURSUIT OF THE 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 liberalization of the economic sphere will force the Chinese Communist Party to implement or to accept political reforms leading to the emergence of a democratic regime.

There is no doubt that the economic take-off had an important effect on the political regime. In order to deliver growth and to solve

contradictions surging in the path of reform, the Chinese Communist Party had to implement economic liberalization (competition, privatization, financial reform) and also reform its methods of intervention, not only in the economy but also in many parts of society. This dialectic evolution has led the Chinese political system to mutate from a totalitarian toward an authoritarian regime. It has created new spaces for freedom in China, some of them unthinkable 25 years ago. As far as democratization of the regime is concerned, however, there is still a long way to go.

Economic factors are pivotal in the democratization process of developing countries. But, outside the general theory put forward by S. M. Lipset in 1959 (Lipset, 1959: 69-105), which states that developed countries tend more often to be democratically organized, there is no concrete marker of 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 eighteenth and nineteenth centuries show that there are no hard rules on this point. This is not to say that the political sphere is completely autonomous of 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" (Hirschman, 1995: 262). The literature that has analyzed different transition from authoritarian regimes to democracy in middle-income countries (Haggard and Kaufman, 1995) emphasizes that economic crises are often a crucial factor that speeds up the evolution toward democracy. It makes social groups supporting authoritarian regime change their mind and induces them to join other groups pushing for a democratic evolution. It is true of private entrepreneurs, who can have a strong influence on investment, employment, and financial flows as well as middle-class and white-collar workers whose support and expertise in running the economy and the bureaucracy are crucial to the survival of an authoritarian regime. Obviously, the ability of blue-collar workers and peasants to organize themselves in independent and

strong institutions is also crucial in pushing an authoritarian regime to accept a democratization.

In the case of China, we can find very few factors in the current economic situation likely to lead to a democratic evolution. As we have seen in the previous section, economic fundamentals in China are sound, especially the level of external debt, which is extremely low by international standards, and the current account surplus, which makes China one of the main creditors in the world. These two factors protect China from the type of external debt crisis that forces developing countries to implement socially painful adjustment programs, or to use inflation as a temporary solution (or, most of the time, both). These two policies often trigger strong social and political reactions from groups supporting authoritarian regimes and lead them to back democratic forces.

Another factor that tends to favor the status quo in China is the attitude of the private sector. Growth and competitiveness rely today on the perpetuation of considerable social inequalities, particularly for China's rural labor force. Given the demographic transition, which is already leading to a shortage of cheap labor from the countryside, the private sector does not have any advantage in supporting a democratic transition that will bring more social rights. Moreover, despite the growing importance of the private sector in China, the number of private firms is relatively small in comparison with other developing countries when they were ruled by authoritarian regimes (South Korea, Indonesia, Brazil, Argentina, or even India during the suspension of democratic rights between 1977 and 1979) (Rodrik and Subramanian, 2004). The public sector remains the dominant player in every corner of the urban economy. Nearly 60 percent of the workforce in urban areas is still in the public sector, and most of the financial resources of the country are in the hands of state-owned banks. This means that if there were a crisis or the country experienced a lower growth rate, the state could still positively influence the economy (as it did during the 1997 during the Asian crisis) and reduce the impact of private entrepreneurs exiting from the coalition supporting the regime. The state has also demonstrated on various occasion its ability to jail private entrepre-

neers for being outspoken on political rights. It also is unclear what will be the impact of Jiang Zemin decision's to allow private entrepreneurs to join (or, in case of former managers of privatized state-owned enterprises, to stay in) the Chinese Communist Party. But so far, as B. Dickson shows in a recent study, private entrepreneurs remain to a large extent in a "noncritical sphere" (Dickson, 2003). This attitude, however, does not tell us what the private sector would do in case of a crisis. The literature on the South American democratic transition (Frieden, 1991) shows that private entrepreneurs are usually nonconfrontational when the economic situation is good but can quickly change their support during a crisis if they think that the authoritarian regime is not able to manage the economy. But again for China, their capacity to dissent and the impact of a potential exit would probably be limited given the grip the party maintains on any organization (including those within its ranks), the financial weakness of private enterprises, and the importance of the public sector to the national economy.

As far as the emerging middle class in urban areas and white-collar workers are concerned, the steady growth in their income since the beginning of the reform makes them supportive of the regime despite endemic corruption and its arbitrary rule. The memory of the turmoil caused by the Cultural Revolution is still vivid and they widely accept the Communist Party's argument that democratization is premature and a risky adventure. Nevertheless, like the private entrepreneurs, their current supportive or nonconfrontational attitude toward the regime while growth continues gives us no indication about a potential evolution or exit from the coalition in a crisis. The literature on the political economy of transition tells us that this potential evolution in periods of crisis depends on the capacity of the government to offer some compensation through raising salaries, maintaining stable energy prices, or providing public investment program (Haggard and Kaufman, 1995). As we have seen, 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, the middle class, and white-collar

workers is undoubtedly receiving considerable attention from the Chinese Communist Party.

The government's response to the peasantry and to the effects of the restructuring of the state-owned industrial sector on the urban working class has been a well-designed carrot and stick policy. The carrot has been economic growth, which limits the impact of restructuring by providing employment for former state-owned companies employees in the private sector or in services (even if many of these jobs are short term) (Solinger, 2003, 61-87), and supplementary funds for peasants who are migrating to cities for short periods. In rural areas, for the first time in China's history, this revenue stream has exceeded revenues coming from agriculture activities (OECD, 2005: 233). More recently, the new government leadership team of Hu Jintao and Wen Jiabao has launched a series of measures in favor of rural areas that include exemption of education fees for children in poor areas, limitation of local (and nonofficial) taxes, and agriculture price supports. These measures have been instrumental in helping them consolidate their power after the tenure of party secretary Jiang Zemin and his allies, but they show also how it is necessary for an authoritarian regime to use means other than repression to reduce social tensions.

For the stick, the Communist Party has suppressed attempts to form independent labor unions and political parties. It is probably in this area that we find the greatest continuity with the former socialist totalitarian regime. It also marks a major difference between China and other former authoritarian regimes in developing countries, since most of them either had experienced democracy in the past or had authorized, under strict controls, the existence of political parties or independent labor unions.

Outside pressure should not 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 governments have renounced any support for democratic forces and their diplomacy is mainly focused on trade issues. On this point, the attitude toward China

is again very different from that expressed toward former authoritarian countries such as the Philippines, South Korea, Taiwan, Indonesia, Turkey, Chile, Brazil, Argentina, and the countries of Eastern Europe. In those cases the United States and to a lesser extent the nations of Western Europe, after supporting these regimes initially, decided in the 1980s to back their democratic transition.

In short, the coalition of blocs in the People's Republic, led by the Chinese Communist Party, tends to favor the continued existence of the political status quo and nothing suggests that one or more of the blocs that are part of the present coalition are willing to risk losing their advantages in a conflict with the party during this period 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 democratization of the regime. The economic take-off and the establishment of capitalism have brought new spaces for freedom in the social life of the Chinese citizenry. These new spaces are quietly working in the long run in favor of democracy. But as long as the economy does not create conflicts among the top leadership, the Chinese Communist Party will retain considerable control over the speed and the degree of democratization.

## **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 toward a capitalist system is well advanced and seems irreversible despite many contradictions and deep problems in the economic system. The critical masses that have formed in domestic consumption, in human resources, and in infrastructure now give China a solid base for the pursuit of its economic development. Many problems remain, however, including the pension and the bank-

ing system, the governance of state-owned enterprises, social inequalities, and environmental degradation. These must be addressed if China wants to maintain steady economic growth.

Ironically, capitalism has emerged as the only alternative by which the Chinese Communist Party can remain in power. The 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 that 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 take advantage of 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 globalization on the catching-up strategies of developing countries, the result is clear to see: a considerable opening up of the Chinese economy that is contrary to the mercantilist strategies seen in Europe, the United States, Japan, and South Korea at comparable stages of development.

The Communist authorities' obstinate reliance on semantic pirouettes and violence in order to pursue economic modernization nonetheless appears increasingly pointless and counterproductive today. First, many of China's economic problems are directly the result of the refusal to allow the emergence of real counterpowers within society. Second, this last quarter of a century has witnessed an intellectual shift in China, accompanied by scientific, economic, and social shifts, that allow us to imagine a progressive evolution toward democracy. Indeed, everything now seems to be in place for this evolution: different currents within the party and within the institutions at the helm of the capitalist economy, as well as rising standards of living and a better educated population. Moreover, the Chinese Communist

Party will maintain during a period of growth the ability to negotiate on its own terms the pace of the democratic reform, its place in the new political spectrum; it will also retain control over public assets (as was the case in Taiwan and Chile). The transformations seen today might indeed allow China to progress serenely toward the “fifth modernization” inscribed by the dissident Wei Jingsheng on the Democracy Wall in 1978 and to reach the end of the long path it has followed for nearly a century that will allow it to enter modernity.

## NOTES

1. “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” (Braudel, 1985: 76). This type of analysis can also be found in Balazs (1968) and Bergère (1998).
2. In 1978, only 600 products were subject to centralized planning; in the Soviet Union, the number was 60,000. See Naughton (1995).
3. See Rodrik and Subramanian (2004) on Indira Ghandi’s change of attitude toward the private sector at the beginning of 1980s after her decision to suppress democratic rights between 1977 and 1979.

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