

# China in Brief to the End of the Twentieth Century

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### China's History

The oldest Chinese books still in existence date back to almost 1,000 BC, although various myths and legends, as well as archaeological evidence, including samples of early writing, indicate that an even earlier period might extend back as far as 5,000 BC. China has the longest continuous history and culture of any currently existing nation, the people are proud, and they possess more awareness of the past than most Westerners. There are many stories and legends in China, some of which occurred a thousand or more years ago, with which any well-educated person is familiar. In contemporary discussion, reference to ancient events and long dead people is common; there is a tendency to look back on history to gain lessons of value and apply them to the present. This attitude provides wide scope for plays and stories, ostensibly about the past, which actually criticise current political leaders and their policies. Chairman Mao was reported to have been incensed in the early 1960s by historical dramas that could easily be taken as an indirect criticism of his regime.

China was a stable empire for two thousand years, in the hands of a series of ruling dynasties. This system only collapsed in 1911 with the passing of the Manchu Dynasty. Its decline had been hastened by the impact of the West, especially by Britain, during the colonial expansions of the Nineteenth Century. The First Opium War (1839-42) had a traumatic effect on Chinese leaders, who began an intense search for the best way to organise China to meet these new and powerful barbarians. After the fall of the imperial dynasty in 1911, there was a brief flirtation with an embryonic type of parliamentary democracy that lasted for less than two years, before President Yuan Shihkai seized total control. His effort to establish himself as a new emperor failed, China collapsed into warlordism, and the nation began to fall apart. After 1916, many independent little "kingdoms" were established, and banditry was rife. In 1927, civil war broke out between the Kuomintang (KMT) and the communists, which divided the country. In 1931 the Japanese invaded China and rapidly took over control of all the important areas. This Japanese presence sucked China into the Second World War and at the end of hostilities the government of China was given to the KMT. The civil war was resumed in 1946 and continued until 1949, when victory went to the communists. In that year, the KMT moved its seat of government to the island of Taiwan, from where it still claims to be the legitimate ruler of all China.

At least nominally, the civil war continues unresolved, although there has been no military action for years. In 1993, both governments began to talk in Singapore, and now exchange high level official visits. There has been a notable economic rapprochement during the 1990s, based on China's need for foreign investment and technology, and Taiwan's need for cheap labour. Currently, the Taiwanese government bans investment in Chinese infrastructure for projects above \$50 million, but the rule is frequently flouted. The inhabitants of both areas accept the strong bond of ethnicity, despite major political differences. Direct China-Taiwan foreign trade is still banned by Taiwan, although since March 1997 foreign-registered ships can ply between Kaohsiung in Taiwan and Xiamen and Fuzhou in south-east China. Indirect trade between China and Taiwan is now commonplace, largely via Hong Kong. Much foreign investment flows from Taiwan to China; official figures show that by 1994 the contracted accumulated total was around \$25,916 billion while Taiwan accounted for 18 percent of that year's contracted total foreign investment. At September 1998, Taiwanese contracted investment had reached \$40.16 billion with investment actually used reaching \$20.86 billion.

## **The Political Scene**

China enjoys government by geriatrics; youth is generally mistrusted with power. Following the views of Confucius, no one under thirty years of age is regarded as being mature, and few under fifty years of age exercise much authority at higher levels of government. Since 1949, anyone who took part in the famous "Long March" (1934-35), when the beleaguered communist forces trekked 10,000 km across China to a safe haven in Yennan in the north-west, has had immense power. He or she was virtually untouchable, however poor the performance. With the passing of time, few are left, but even being related to such a person can bring social status and local power.

### ***The political system***

China is an authoritarian, one-party state, under the control of the Chinese Communist Party (CCP). Eight unimportant non-communist parties are allowed to exist and have grown but slightly in importance in recent years. This means they have changed from having no power at all to possessing an insignificant amount. Attempts by "dissidents" to establish a true democratic opposition party result in those involved being arrested. The CCP is the executive power in the land, and has mostly been run by a single person with immense control: in effect, this makes him a dictator. For a time during the Cultural Revolution (1966-76), Mao Zedong's wife, Chiang Ching, exercised much power, but as one of the Gang of Four, she was eclipsed shortly after the death of Mao in 1976. Other than that brief interlude, high political power in China has been in the hands of males since 1911.

At the top level of politics, there is the supreme leader, and under him the Central Committee. This is an important level of power, where the leaders of the political factions are based. Power passes from one leader to another, and their factions rise and fall with them. At the centre of the Central Committee is a small Standing Committee which, unlike the full Central Committee, meets regularly. This is the real centre of power for those just below the supreme leader; it is something like a Cabinet in Western terms but, together with the top person, possesses more power. It is not trammelled by considerations of democracy or having to please the people to get re-elected.

The legislative power in China is the National Peoples' Congress (NPC), which until recently has been a lap dog totally under the control of the CCP. During the 1980s it began to assert itself in minor ways, which seems striking to the Chinese and to some foreign observers. Nonetheless, NPC is hardly an independent body and cannot be regarded as possessing the power of a Western Parliament. Despite occasional (and well-publicised) critical speeches, the CCP is still able to dominate it without worries about any real opposition.

China is divided administratively into 30 bodies of provincial status, including a few Autonomous Regions and Direct Run Cities. Each has its own government. Below these are more than 2,000 counties, and various towns, each with its own local government. Because China is so vast, much power has to be decentralised to local levels; many important decisions are made here, not always in line with central policy laws.

Since December 1978, the CCP has been engaged in a major effort to resuscitate and improve the economy. That was the year that Deng Xiaoping finally got the numbers and gained control, after two years of intra-Party struggles. These had surfaced immediately after the death of Chairman Mao

Zedong in September 1976, and involved two issues: who should run China, and along what policy lines. When Mao died, the country had an inefficient moribund economy and a people wearied of political upheaval and change. Deng Xiaoping set about modernising China, cautiously at first, and then with increasing speed, as the reforms took root.

### ***Domestic political policy***

The overall policy of the current leaders of China can accurately be described as "Communism with an acceptable capitalist face", although the official version is "A socialist market economy with Chinese characteristics". The socialist market economy was written into the Chinese Constitution in 1993 by a series of amendments. The current Constitution, the fourth since 1949, was adopted in 1982. The thrust of policy since 1978 has been to reform a moribund economy while maintaining the political monopoly of the Communist Party. Currently the leadership has no intention of moving towards a Western democratic system, but some observers feel that it will be pushed into doing so.

Domestic political policy since 1978 has included the following:

- Ending Maoism and removing all strong Maoist sympathisers from positions of power.
- Replacing such people with pro-market sympathisers and thereby reinforcing the position of the ruling faction.
- Preventing the Stalinists from regaining control within the Party.
- Maintaining the CCP in power as the process of reforming the economy proceeds.
- Keeping the Peoples' Liberation Army (PLA) on side with the pro-market faction and use them to support the reformers and to maintain civil order and control. This includes holding China together and avoiding any danger of provinces splitting away or China descending into civil war.

The country has traditionally been difficult to hold together because of its size; typically, it has started to disintegrate as the ruling dynasty weakened, then been pulled together again by strong central leadership under a new dynasty. The current leadership, well aware of this pattern, is striving to prevent this traditional weakening process from getting under way. This is one reason they were prepared to get tough in Tiananmen Square in June 1989 and send in the troops.

These political aims have been successfully achieved. Domestically, the Maoists have been whittled away until there appear to be none left. Underneath the political surface, they are thought to continue to exist, but lacking any real power base, they currently show no sign of resurgence. The Stalinists are thought to be well outnumbered, but remain hopeful, and have a few powerful backers in the Party. There is no sign that the pro-market leadership faction is going to lose power in the near future.

Politically there has been little fundamental change: the Communist Party is still in charge and allows no serious opposition, although its own power and stature have certainly diminished. The economic reforms have continued, and so far been successful. This is particularly so when compared with the situation in East Europe, especially with the former Yugoslavia or USSR. In China, the state has been maintained, civil war avoided, and the Party kept in power. The political decision-making process is neither chaotic nor paralysed. Firm control has been maintained, even as the shackles on freedom have been slackened.

The movement towards increased use of the market has been relatively slow and careful: the rulers slackened power a little and watched closely. Different things were tried out in different areas and the results compared. What had succeeded was then adopted as official policy. This bottom-up pragmatism has meant that policies have been appropriate to actual conditions, rather than being imposed from above and hence possibly unsuitable. During the 1990s, the use of market mechanisms has accelerated.

The PLA has supported the ruling reformist branch of the CCP and intervened in Tiananmen Square on 4th June 1989, to put down the students and workers and maintain the status quo. The reform process had been accompanied by features that antagonised many urban residents. These included corruption, inflation, a rise in the level of uncertainty, and a diminution of the standards of public and private morality. Disquiet turned into opposition and demonstrations. Those involved in Tiananmen Square were mainly students, plus a few workers, especially journalists. They kept encountering good stories but were prevented from reporting them, and were resentful. Some of the demonstrators were protesting against the above unwanted features of the economic reform process; others simply wanted a bit more freedom; and a few others probably did not know what they wanted, other than a change of some kind.

The result, when the army went in with its tanks, was to squash the hopes of a relatively limited number of Chinese, largely confined to the educated and literate, roughly equivalent to those referred to in Britain as "The chattering classes". The vast majority of Chinese are peasants and were uninvolved in any of the Tiananmen furore. In poor areas, the horizons tend to be limited to survival; in better ones, people are concerned about economic improvement. The peasants' interest in politics does not loom large. There is probably more concern about democracy and Chinese human rights abroad than in China, and the Tiananmen episode antagonised many foreign observers. The latter tend to identify with both Western values and middle class aspirations. Self-exiled dissidents, mostly in the United States, press steadily for democracy in China, but seem to have relatively little support within the country. The present students in China are sometimes criticised by both foreign observers and dissidents abroad for being uninterested in such matters, in sharp contrast to the generation that preceded them.

In practical terms, the Tiananmen massacre caused few economic losses and these were short-lived. Economic growth rapidly resumed; the minimal sanctions imposed by foreign countries were soon abandoned; and the foreign tourists quickly returned. As early as 1991, the number of tourists visiting China, and the foreign exchange earned from them, exceeded pre-Tiananmen levels. Foreign investment also recommenced and in 1993, China overtook Mexico to become the largest recipient of foreign direct investment in the world, a position it has held since. This is despite a tightening announced by the State Council on Boxing Day 1995, which included measures that could have deterred foreign investment. These included the ending of the right of newly formed foreign ventures to import equipment and raw materials free of customs duties and value-added tax. The full measures came into effect on December 31, 1997, which, together with the current Asian financial crisis, might lead to a fall in foreign investment in 1998. You should be aware that the real size of foreign investment is a little unclear because some Chinese companies quietly move capital to Hong Kong, and then formally send it back to China as "foreign investment", in order to qualify for special treatment.

The PLA, once a Maoist stronghold, was previously trained to fight guerrilla wars, and possessed little modern equipment. It now has a brand new role: to maintain civil order and to become a more modern, Western-style army. Its equipment and training lag well behind its new role, because China is too poor to put sufficient resources into defence, despite increases in the defence budget since the late 1980s. The PLA has just over 3 million on active service, although intends to trim down to two and a half a million over the three years to the end of the year 2000. The army is heavily involved in marginal military matters, and operates over 20,000 companies in transport, hospitality, entertainment, real estate and satellite launching. It is believed to sell 83 percent of its industrial output to civilians, and an estimate suggests that commercial sales exceed the official state defence budget of \$9.7 billion. It is widely regarded as being seriously involved in criminal activities, including smuggling. In July 1998, President Jiang Zemin ordered the PLA, as well as the police and judiciary, to close down all their commercial enterprises. He apparently believes the temptations of commerce to be incompatible with honest dealing in their more normal functions. This is supposed to happen by mid December 1998, when all such assets must be handed over to SETEC to control.

## ***International politics***

Since 1978, China's policies at the international level have been to move China back into the world and increase the number of friendly nations, while developing foreign trade and foreign investment in China. In the longer term, the intention is to make China globally a great nation. Precise goals have included reducing tension with Vietnam, removing the wide political gap between China and South Korea, and moving closer towards Taiwan. These international aims have been achieved. The collapse of the Soviet Union fortuitously removed an enemy for China -- previous border disputes, as well as major ideological differences, had earlier put them seriously at odds with one another.

South Korea established diplomatic ties with China in 1992 and is now an important trade partner and a decent source of foreign investment, ranking sixth in the list of countries and regions with investment in China. Taiwan and China, both still insisting that there is only one government of China, have begun to talk openly as well as engage in trade. Taiwanese firms invest in China and *de facto* there are two political states, although the concept of "Two China's" is a prickly one that neither China nor Taiwan will accept. China *never* refers to Taiwan as a "country" and Taiwan will not accept the concept of "One country, two systems" in case it might help to lead to reunification under a communist leadership.

The future of the two Western colonies, Hong Kong and Macao, has been settled: Hong Kong reverted to China at midnight on June 30 1997 and Macao will do the same on December 20 1999. They are, or will be, run as Special Administrative Regions of China. For China's sake, the process of transition of these two areas should be as smooth as possible. This is a major reason why in December 1993 China strongly objected to the introduction of a degree of Western-style democracy in the then colony of Hong Kong. China saw the issue as a blatant attempt to limit its future sovereignty and an exercise in cynical political manoeuvring by Britain. China pointed out that democracy in Hong Kong was a feature that Britain was more than happy to do without, as long as it had sole responsibility for the territory. Britain saw the issue as a way of increasing the guarantee that China would abide by the agreement on Hong Kong, and in particular keep the promise to avoid any major changes for fifty years. After one year's experience, Hong Kong is clearly being run without any of the heavy-handed interference that some feared. Either Beijing is better behaved than expected, or action has been deferred by the economic problems resulting from the Asian financial crisis that began in 1997.

Other strands of China's international political efforts include developing and increasing international respect for China, maintaining political independence, and preventing any interference in China's domestic affairs. The issue of civil rights for Chinese citizens, including the minority areas such as Tibet and Xinjiang, falls in this area. The aims of respect and independence have been successfully met, but civil rights, especially in Tibet, remain an issue for which China is regularly criticised. The USA in particular tends to do this on an annual basis. Each year, Congress votes on the issue of whether to extend m.f.n. treatment to China known as (Normal Trading Relations or NTR since 1998) and various China critics take advantage of the occasion to raise the issue of human rights. The Chinese, who are a proud people with an immensely long recorded history and culture, do not take kindly to this process of foreign criticism, which is resented as being an open interference in the internal affairs of China.

In 1988, China applied for readmission to GATT, now the World Trade organisation (WTO), but discussions about the conditions for entry have still not been concluded. It will not be an easy task, for although China's economy has been greatly reformed, it is still far from being a free one, and many market restrictions continue. These include subsidies to SOEs, quotas and licenses, many tariffs (some of which are high), considerable arbitrary official interference, and the continuation of secret, unpublished regulations, particularly at lower levels of government. None of these is compatible with WTO membership, but as China continues to reduce its reliance on administrative controls, it should find admission easier. On the issue of Taiwan, China is prepared to allow it to join the WTO, but it must sit as a separate customs area of China, not as a country.

## **The Economic Scene**

Between the early 1950s and the late 1970s, China put in place a ramshackle planned economy. Although total planning of the economy was sought, this was never achieved. The task was too immense in such a vast country, with its problems of communications and transport, shortage of skills, and record of regular political interference. During the Cultural Revolution (1966-76), radical political rectitude replaced economic progress as the goal. At the death of Chairman Mao (1976), the economy was in a poor state. As a result of political extremism, the people had learned that it was dangerous to be seen to succeed or raise their personal living standard; such an attitude was clearly inimical to economic growth. Other economic problems included a statistical reporting system that was in tatters, so that no one knew much about the real situation in the nation. Resources had been grossly misallocated for years, and agriculture in particular had been starved of financial investment, so that no modernisation had occurred. Labour intensive methods were used by hundreds of millions of peasants, organised in communes, production brigades and production teams, with correspondingly low levels of productivity. In industry, workers had been demoralised and the once proud work ethic of the Chinese had been eroded or removed. Such economic growth as had occurred had been uncontrolled, with the result that good agricultural land had been lost to cultivation, while pollution of air and water had become serious problems.

The issue of the economy had to be tackled, especially as the population had increased considerably. By 1976, it was 73 percent above the level of 1949, but despite well-publicised land reclamation, the amount of arable land available had barely increased. This was because of inroads by industrialisation, urbanisation, and road building. There was little attention to economic matters during the Cultural Revolution (1966-76). Premier Zhou Enlai valiantly tried to keep the economy running normally, despite political upheaval and, in his later years, the crankiness of a doddering and vindictive Mao Zedong.

Socially, by the time of Mao's death, the Chinese people were ready for a change: they had suffered too much. They were tired of the political terror, the all-pervading influence of radical politics on every detail of ordinary life, and they wanted peace. A return to normality was clearly needed, but it was unclear who was to supply this, or indeed what normality meant. For many, it meant a return to Soviet-style communism, with five year and annual plans within a regime of a command economy, and the reinstatement of a rather grey, bureaucratic, dull but predictable situation. Such a group, under Hua Guofeng, seized the reins of power 1976-78, but soon lost them to Deng Xiaoping and his followers, who had a very different answer to the problems of the lacklustre economy.

By late 1978, Deng Xiaoping had taken over the Party leadership. He began to allow relaxation of the commitment to central planning and permitted some, if minimal, use of the market. This policy was engineered from above, although it rapidly got out of hand and gained a momentum of its own as grass-root activities pushed ahead of central caution. The process began on a limited scale in agriculture but before long it led to the disbanding of communes and the introduction of private farming on what was nominally state-owned land. Efforts to introduce private methods in state run industry were not particularly successful for a long time, but shares in some state owned enterprises were sold. A primitive capital market was established, with limited stock markets set up in Shanghai and Shenzhen SEZ, on which selected companies are allowed to be listed. Currently, these number about seventy. Other large state firms have been broken up and their monopoly positions removed. The state airline, China Administration of Civil Aviation (CAAC) suffered this fate. In industry generally, privately run firms are now allowed and the number has grown sharply in recent years.

### ***Distribution***

Wholesale markets did not exist until recently, as there was no need for them under central planning. Several such markets were established in the early 1990s, covering commodities such as timber,

building materials, farm machinery, coal, petroleum and metals. In 1993, the Shanghai Metals Exchange became the third largest in the world, after London and Chicago. The previous ludicrously low prices for capital goods and basic raw materials have begun to increase and are slowly moving towards international levels. China says that it expects to have an efficient market distribution system for all such types of goods by the end of the century but it is doubtful if this can be attained. Meanwhile, it is sometimes possible for a foreign company to set up its own informal distribution system that can work well. PepsiCo managed this with a Sino-Taiwan joint venture called Wang Wang, which distributes Cheetos and some other PepsiCo products. In exchange, PepsiCo produces Wang Wang's Lonely God potato twists.

## ***Labour***

A few steps along the way to establishing a labour market have been taken. No longer are the children of all peasants doomed to work all their lives as peasants in their turn, nor are the offspring of all workers allocated to jobs on a rather ad hoc and inefficient basis by the state. Youngsters are no longer forced to "Wait for employment", a euphemism which meant that they were not allowed to describe themselves as unemployed nor counted in the figures. Peasants are still in theory tied to their local area by the *hukou*, or household registration system. In practice, they now have more freedom to move and so many have migrated to urban areas that they are known as "the floating population". They number perhaps 80-100 million people in all. However, when they get to the city they have no right to remain there, they lack access to official services, and they can be sent back without warning to where they are officially registered.

Within cities, workers can apply for jobs rather than being forced to wait until allocated one. They can also move to seek work for themselves, more or less legally. They can even set up their own firm if they wish, providing they have both the talent and capital necessary. Some government employees are now allowed to "moonlight" and accept second jobs, and many more do so without permission. Part-time and casual work has proliferated during the 1990s. Local personnel exchanges have been established in major cities, allowing workers to register for transfers to new organisations or areas. These were previously almost impossible to achieve. Wages, once stuck in a rigid 8-grade system, have also become flexible: local areas can set a minimum wage and enterprises can now set the wage they wish, at or above that level.

The Labour regulations that came into force on January 1 1995 are an attempt to lay the foundations of a labour market, suitable for a modern economy that is based on the price mechanism. It aims to bring the moribund state-run sector up to the standards of the enterprises operating with foreign capital. It made provision for a minimum wage, social insurance, workers' rights and an absence of discrimination in hiring. Previously, different labour rules applied to SOEs and to enterprises with foreign capital; this law aims to achieve unification by moving the SOEs up to the standards of the best enterprises. This requires them to end the cradle-to-grave welfare coverage provided by the SOEs, such as housing and sickness benefits. "The iron rice bowl" was to be eliminated. This picturesque phrase means that one's job (which provides or fills the rice bowl) was totally secure for life (a rice bowl breaks if dropped, but an iron one does not). Without fear of dismissal, many of those employed in SOEs did not work hard and over-staffing was general. Perhaps up to a third of the workers had no real work to do. To combat this, labour contracts, rather than jobs for life, are to be extended in the State-run sector until they became the norm.

A serious effort is being made to improve work habits, including merging some SOEs and dismissing surplus workers. Some of the worst SOEs have been allowed to go bankrupt. The government stepped up the pace in 1996, and 6,232 firms went bankrupt in that year alone. This number was triple the figure of 1995 and almost one third more than the total of the entire previous eight years. However, the

number of SOEs losing money still rose 49 percent between November 1995 and October 1996, indicating that there is a long way to go before the problem is solved.

At the Communist Party Congress in September 1997, the 300,000 SOEs were given three years to organise their affairs, which meant that they had to make profits, become involved in mergers or sell-offs, or go bankrupt. As the policy goes into effect, it will involve the dismissal of millions of workers. With around 113 million workers in SOEs and over one third of SOEs losing money (mid 1990s), the increase in unemployment will not be small. According to officials from the Ministry of Labour and Social Security, some 8 to 10 million will be made redundant over the three years. This could be an underestimate, and if all those not essential to production were to be dismissed, the figure might be closer to 20 million. In the first half of 1998 in the cotton textile industry alone, some 400,000 were made redundant, after 134 companies went bankrupt and another 217 were merged.

Another strain on employment provision will come when the authorities close some 22,000 small illegal coal mines by the year 2,000 as they intend to do. The plan to reduce the size of the PLA by half a million soldiers within three years, announced by Jiang Zemin, will throw additional people onto the job market. One hundred thousand were released in September 1998.

The unemployment position can only be worsened if the government fulfils its intention of dismissing millions of bureaucrats by abolishing some Ministries and halving the total number of government employees. This serious effort to improve efficiency looks to be an act of conspicuous political bravery, under the circumstances.

Official statistics claim an unemployment rate of around 4 percent in 1997 but this only measures those registering at Re-employment Centres. Few bother to do this, either because they know there is no work on offer and have given up, or else they mistrust the centres as exploitative, rip-off organisations. The many workers not formally dismissed from SOEs, but merely sent home to wait, are also not included in the unemployment figures. In 1997, 11.51 million workers were laid-off, of whom 7.87 million were from SOEs; 4.8 million of these did not find work, but are not counted as unemployed. There is much uncertainty, but including those from previous years, the number laid off and with no job to do may number 12 million. Including those missing from the figures, a reasonable guess at the true level of urban unemployment might fall in the range of 25-30 per cent. In late 1998, China admitted that that the unemployment rate would hit 9 percent in 1999. This is still too low and the authorities continue to mislead themselves and others. There are about 160 million unemployed in rural areas who are not counted in the figures.

Unemployment is particularly bad in north-east China, where heavy industry was strongly developed under previous central planning. Twenty-eight percent of all the unemployed live in the three provinces of Heilongjiang, Liaoning and Jilin.

Starting in 1998, a social welfare scheme began to be introduced to help those laid off, retired or disabled. It is hoped that by the end of that year it will be in place in all large cities, and in about half of the townships. It will provide payments of between 70 and 250 *yuan* (approximately \$8-\$30) a month to those who qualify. Previously, the small number of workers able to receive benefits were paid by their work unit, rather than a state office. Many of those laid off have languished unemployed; some have tried to scratch a living working as a street trader or running a small food stall. Farmers, who make up two-thirds of the population, are excluded from the new scheme. The new welfare scheme will place heavy demands on budget revenue. It seems that the government hopes that the savings in subsidies from merging or closing the loss-making SOEs will be sufficient to cover the new benefit payments to workers. This optimism is surprising, and it can only be hoped that the Treasury officials have done their sums properly.

In view of possible financial strain and the probability of tension that could culminate in serious social unrest, the government might be forced to stop closing loss-making enterprises. Rather than allow many SOEs to perish, it could choose to coerce them into conglomerates, rather like South Korea's *chaebols*, which are admired at high levels. This would be a movement away from the pursuit of microeconomic reform and possibly delay China's entry into the WTO.

A swing towards *chaebols* would probably entail China moving towards "picking winners" and adopting policies to promote specific industries. In this event, the motor vehicle industry will probably be the first selected. Such a move would necessitate China increasing the level of protection from foreign goods and services rather than reducing them as it has been doing. In turn, this could further delay China's application for WTO entry.

### ***Prices and the financial sector***

In the consumer market, many prices have been freed from the straightjacket of administrative price fixing and perhaps 90-95 percent of prices now reflect supply and demand. Every effort to free prices for a group of items has meant an immediate price rise, because for decades prices were held artificially low. Increasing prices hurt urban dwellers in particular, and the government tries to cushion the effect by providing a subsidy. This is too small to offset the price rise totally, but from the recipient's viewpoint, it is better than nothing. It does however add to the recent intractable problem for the central government budget, of having large subsidies on the expenditure side, while revenues languish.

The financial sector is weak and the banking system is poor and backward. For years, it was merely there to offer an outlet for savings and to supply SOEs with the funds they needed to meet the plan. The banks are unable to function efficiently in the style needed to run a market economy. There is no automated payments system; bad bank loans are endemic; and it is probable that if ever forced into adopting proper accounting, the entire system; would be technically bankrupt. Over the years, provincial governments have pressured the local branch of the People's Bank to make unprofitable and downright bad loans, partly to keep loss-making state run enterprises in operation. In 1997, the People's Bank of China conceded that bad loans were 5-6 percent of total loans, three times higher than previously admitted. A different claim, also in 1997, said that the People's Bank of China confessed that 13-14 percent of outstanding loans were non-performing, i.e., there was no payment of interest or repayment of capital. It pointed out that foreign analysts feared that as much as 40 percent of loans could be non-performing. Part of this total, and possibly all, will be unrecoverable. Whatever the exact figures, China's financial sector is in trouble.

The authorities are well aware of the weaknesses in the financial sector and have begun to correct them. It was announced in November 1998 that all municipal and provincial branches of the People's Bank would be abolished and nine regional bodies would take over their authority. This is an attempt to remove the damaging pressures on local banks by Provincial governments. This is part of a process of general financial reform under which a new body will be established in the middle of 1999 to clear the bad debts in the banking system.

The currency of China, the *yuan*, is not fully convertible, although China has stated that it will move to this within five years, as part of its intention to join the WTO. This makes the target date the year 2000. An early step in this direction occurred on January 1 1994, when China discarded the fixed exchange rate system and abandoned Foreign Exchange Certificates (FECs), a special currency issued only to foreigners. These had discriminated against the foreigners, who were forced to buy FECs at a poor rate of exchange. The several different rates of exchange that once existed are now unified, and it is anticipated that the *yuan* will ultimately be allowed to float, although this will be a "dirty" or managed float, rather than a fully free one. The *yuan* is freely convertible at designated banks, but only for foreign trade purposes and by those enterprises with the necessary trade documents (i.e. there is current

account convertibility). The free movement of currency across the border (capital account convertibility) is not yet allowed.

### ***Foreign investment and foreign trade***

Foreign investment is strongly sought by China which, after a slow and shaky start in the early 1980s, has managed to attract a considerable amount. Despite economic fluctuations, caused by both domestic and foreign events, the flow of foreign investment has sharply increased. Between 1979 and mid-1993, total foreign funds invested in China amounted to some US\$44 billion; official figures reveal that in 1992 alone it amounted to some \$11 billion, while contracts were signed in that year for a further \$57 billion worth. It is believed that four-fifths of total foreign investment comes from Overseas Chinese, often based on provincial ties and family relationships. Over half of the foreign investment comes from Hong Kong and Macao alone. Overseas Chinese investment tends to scatter more widely than non-Chinese foreign investment, which restricts itself more to SEZs and the open cities.

The policy on foreign investment is to try to focus it in the areas of basic infrastructure and high technology. Only gradually is it being permitted in service areas, such as banking and insurance, where its role is still strictly limited.

In 1998 there were some 240 International Trust and Investment Corporations (ITICs), a form of non-bank investment firm taking accepting savings and foreign loans for investment. They are often run by provincial governments, offer a relatively high rate of interest on savings but invest in high risk projects, show-case pieces for the local authority, or prop up dying state operated enterprises that will never be able to repay the loan. The central government planned to close many down, following the collapse of the Guangdong International Trust and Investment Corporation (GITIC) in October 1998. It was previously believed by most lenders that it was safe to lend to ITICs as they were government backed, but this is only the case if the foreign loan is registered with the government, and many have not been.

Five Special Economic Zones have been established, which offer concessions, and supply many necessary services. In 1992, the SEZs were responsible for supplying thirty percent of all China's exports. In addition to the SEZs, fourteen coastal cities have been opened to foreign investment. A myriad of tiny development zones have been established, with relaxed rules, but often with no location advantages, in both coastal and interior China. Many of these were closed in and after 1993, in an effort to reimpose central control and to prevent competitive wastes. Thirty-two national "Economic and Technological Development Zones" now exist. The provincial capitals of all coastal provinces are now accepting, and in almost all cases rather desperately seeking, foreign investment.

Since 1990, China has begun to move towards establishing free ports. Thirteen free trade zones have been set up around coastal harbours as a first step towards establishing free ports proper. At present, they are in embryonic stage, and look very similar to SEZs. Foreign currency circulates within the free trade zones, and bonded warehouses reduce the number of bureaucratic restrictions.

As part of the transition to a market economy, the level of tariffs has been reduced, notably in 1995-96, when duty on about 4,000 goods was lowered. This brought down the simple average tariff level from 36 per cent in 1995 to 23 percent in 1996, a sizeable fall, but still above the 15 percent that most developed countries strive to maintain. Non-tariff barriers loom large, and include special licensing requirements, certification requirements, and import quotas. Other problems include *guanxi*, whereby a Chinese firm with the right connections may be able to avoid duties; local rules at variance with national ones; and local officials, who have the power to make decisions in grey areas, determining which rules apply, and thereby altering the duty payable. Customs officers may treat the same goods

differently, depending on the country of origin, the location of any intermediate manufacturing site, and the final destination market.

By 1998, surplus capacity had emerged in many industries. This was the result of years of high foreign investment and an explosion in foreign-owned enterprises. Over five hundred goods were being produced at less than 60 percent capacity and competition was fierce. The government's response was to encourage companies in these areas to transfer factories overseas, to the Middle East, South America, Africa and Central Asia.

Capital outflow, much of it illegal, is an ongoing problem. At times when it is feared that the *yuan* might be devalued, the outflow increases. This occurred in 1998.

Foreign trade has expanded sharply for several reasons. Firstly, the success of the program of economic reform, and moving back into world markets has pulled in imports and opened new export markets. Secondly, China has strongly promoted trade and offers a good market for many products. Thirdly, the efforts of the many foreign investors in China have boosted the capacity to both export and import. As a proportion of national income, foreign trade rose from 10.3 percent in 1977, on the eve of reform, to 18.5 percent in 1995.

The southern province of Guangdong is an area of particularly high growth, especially in the Shenzhen SEZ and around the Pearl River delta, including Guangzhou (Canton City). The British colony of Hong Kong returned to China in 1997 and has added considerable economic muscle and weight to southern China, although this is currently hidden by the adverse effects on China of the Asian financial crisis that emerged in 1997. Other major Chinese cities try hard and offer special concessions to foreign investment. Notable among them are Shanghai, Dalian, and Tianjin, but many smaller cities are prepared to deal and offer special concessions. The central government occasionally clamps down on such projects, because either in its view, a locally designated development area seems unlikely to succeed, or else the city or province is felt to be offering ludicrously large concessions.

### ***The macro economy***

China is undergoing a major economic change that amounts to a small revolution. The economic reforms have begun to introduce market elements into what was a planned economy, so that there is a mixture of State-run and private firms, in both production and distribution. The process has been accompanied by confusion between the two systems, especially as the border between the two continues to change, and leakages occur across the boundaries. Control by the planners has been drastically reduced, corruption flourishes and grows, but on the plus side, much dynamism has been injected into the economy.

The overall economy has done well under the reform program and China is now the third largest economy in the world. It proved immune to the world recessions of the 1980s and early 1990s and even the major Asian financial crisis that emerged in 1997 has only just started to have an impact on China (at October 1998). With an inconvertible currency, China did not face the problem of "hot money" and the rapid withdrawal of foreign funds.

Economic growth slowed in 1998 and China may not make the targeted figure of 8 percent. The original long-term government target of an average growth rate of six percent until the year 2000 was being so easily exceeded, that eventually it was increased to eight-to-nine percent. Until the Asian crisis, the only problem that China faced in the area of growth was trying to moderate it without causing a major slump. The tools of fiscal and monetary policy, once non-existent, are still primitive and blunt, so that

the process of controlling economic growth in China has been likened to slowing down a motorcar by running it into a brick wall!

Inflationary pressures are endemic, partly but not entirely the result of rapid growth. Other reasons include the inability of the centre to raise enough revenue to cover expenditures; money supply blow outs; slack credit control by banks especially at the provincial levels (where local officials often order the banks to lend to local schemes); local government investment sprees; expanding use of trade credit among the rapidly increasing number of firms; and speculative property booms.

The balance of payments suffers when growth is rapid and inflation worsens. The balance of trade tends to seesaw between surplus and deficit. The deficits are partly the result of economic growth sucking in imports, and partly because price rises make exporting more difficult as imports become cheaper. Quota and licensing controls over imports have steadily been reduced, but have not yet been eliminated. The ability to apply administrative import controls exists, and these are imposed without warning if the balance of trade deteriorates too much. When such controls are applied, they tend to be relaxed as soon as the economic situation improves.

Along with the adoption of freer market policies, the amount of central control has sharply diminished as the provincial and large city governments have gained more power. This has meant a fall in tax revenues, which are gathered at local levels but are often not fully handed over to the centre. The taxation system is being reformed, which essentially involves the introduction of tax farming. Provincial governments negotiate how much they will hand over to the centre each year, and then can keep any surplus that they raise. This favours the rich coastal and southern provinces, which can negotiate a deal that allows them to keep a larger surplus.

There is no possibility of the central government replacing this lost tax revenue by profits from its own direct run industry. First, many state run firms have been privatised, while new ones are not being created. Second, previous tax reforms have increased taxation on the SOEs and reduced profits. Finally, about one third of state firms lose money and admit it, while another third probably do so but manage to conceal it, so the profits are simply not there to be taken. The loss-makers survive only because the banks are instructed to keep extending loans to them, which of course adds to inflationary pressures by increasing the money supply.

The brave attempt to reform the economy and use market mechanisms to improve economic efficiency that had been in force since the end of 1978 began to falter in 1998. The reasons include:

- The easiest things had been done; the harder ones, like reforming the SOEs, are proving to be more difficult.
- Social problems, like the increasing unemployment, became an increasingly serious worry.
- The Asian financial crisis, threatening to turn into world recession in 1998-99, slowed the Chinese economy by adversely affecting exports and slowing the inflow of foreign investment. Problem fixing is always easier when it occurs within a growth framework.

## **The Social Scene**

China already had a large population for hundreds of years before it became a problem elsewhere in the world. Because of the large concentration of people in cities and the dangers of social unrest that this posed, effective methods of social control had to be developed. This included holding the entire family responsible for the actions any of its individual members. There was also a crude neighbourhood watch system, where one family was responsible for reporting any antisocial behaviour by ten other families. People learned to get along with each other, as there was no real alternative. The social system, with

its emphasis on family, has altered in detail, but has proved long-lived, backed as it is by Confucian values. This contrasts sharply with the rule of law, which with its emphasis on responsibility for individual actions has never been a feature in China.

### ***Social policies***

Rather than taking centre place in their own right, social policies since 1978 have mainly tended to be spin-offs from economic and political changes. The social policies have included the following.

- To encourage people to become rich; this compares with the pre 1976 period, when this was actively discouraged.
- To release latent entrepreneurial efforts in order to kick-start the moribund economy and modernise quickly. It is similar in essence to one of the goals of Thatcherism in Britain in the 1980s. Some of the results, such as a widening of income distribution, are similar too.
- To try to contain corruption and reduce it, or at the very least prevent it from continually increasing.
- To tackle crime in general and reduce its level. China is still a safe country, especially for foreigners although there is no denying that the level of crime has increased along with the freedom and breakdown of tight Communist Party control.
- To try to slow the rate of growth of population and aim for a long term fall. "The one-child family" policy has been implemented widely, but with different degrees of severity, depending on locality. Exceptions have been made for a few groups, such as minority peoples and for some parents who have a girl-baby the first time. Forced abortions, even late term, are common in those areas which impose the strictest control, yet are unknown in slacker areas where two children may even be allowed. By 1993, the family planning program was showing signs of failure, and a baby boom was underway. Chinese statisticians pointed out that the targets for future population sizes would not be met. The key reasons are rapid economic growth and reduced control; these are expected to continue, which casts pessimism over the likely success of family planning policy.
- To allow private schools and education to cater for the needs and aspirations of the newly rich families. The state educational sector is under heavy pressure: teachers are poorly paid, inadequate in quality, and many have left to earn more money in other sectors. A new educational program announced in 1993 hoped to revitalise the system, raise teachers' conditions by gradually increasing salaries, and improve the quality and relevance of subjects taught. It also foreshadowed the introduction of student tuition fees in higher education and a loan scheme for students from poorer families. Universities and other higher level institutions will be allowed more power to manage their own affairs.

### ***Social change***

Since the early 1980s, China has undergone rapid social change: freedom has been greater, incomes have increased, and employment in agriculture has grown more slowly than in industry, commerce, transport and production. Workers in private industry, including the self-employed, are now numerous, and, once denigrated for political reasons, are now better regarded in society. Until quite recently, a self-employed person was regarded as a failure, i.e., someone unable to get a proper job; now even university graduates sometimes opt to work for themselves rather than to join a state firm. However, a job in a foreign firm or joint venture is considered highly desirable, as it means earning more money and enjoying higher social status.

The increased freedom is genuine but has occurred within defined limits, although what these are at any particular time is often unclear as the lines keep being redrawn. It is still not permissible to oppose the

Party politically, support the Kuomintang in Taiwan, set up a political party, or ask for Western style democracy. People are however freer to move. This was forbidden until recently, unless one was transferred (often forcibly) by one's work unit.

In the effort to increase living standards and promote economic growth, private entrepreneurs have emerged and are doing well. Some have become very rich, and there is a claim that there are now a million millionaires, even in terms of US dollars. Overall, the majority of the Chinese are unarguably materially better off than they were a decade ago, some of them considerably so.

Some, however, have been left behind as income differentials widened. In 1996, the ratio of urban-to-rural dwellers was 2.5:1; this is officially expected to widen to 2.7:1 by the year 2020 but the outcome could easily prove greater than that. A survey in 1994 found a Gini Coefficient of 0.434, compared to only 0.2 in 1978 on the eve of reform, and 0.385 in 1984 after the early reforms had begun. The ability of some to pull well ahead of others causes resentment amongst those not able to increase their earnings sufficiently.

Private industry and trade are permitted and encouraged in this socialist country, because of the belief in the efficacy of market systems, and because the pressure of population means the need to provide employment is great. The number of peasants greatly exceeds the number required in agriculture, and, after 1978, people were encouraged to move out of agricultural work. As they did so, the rate of growth of agricultural output roughly doubled, reflecting the existing low marginal productivity of labour, as well as the newly released enthusiasm of those remaining. Most of China's peasants are now better off but still poor, and a tiny proportion has become wealthy.

The standard of living of the Chinese people has improved immensely because of the reform policies. The measurement of "well-off-ness" using the traditional national income per head is misleading when applied to China, as it severely understates the ability of people to buy things. Estimates by the World Bank of GNP per capita in 1994 show it at \$530 in current international prices; but using the "purchasing power parity" (ppp) approach, to take account of local prices being much lower than abroad, GNP per capita reached \$2,510. By 1996, again on a ppp basis, GDP per head was estimated at \$3,120.

The higher living standard is not only the result of increased wages: an official survey involving 15,600 urban households drawn from 30 provinces, municipalities and autonomous regions, revealed that almost one in three urban workers were engaged in a second job. In 1996, this increased their earnings by 35 percent. Moonlighting is common, especially for those in the public sector, where fixed wages have not kept pace with economic growth.

Along with freedom and growth has come increased corruption, as China began the transition from central planning to a market economy. Differential prices between the controlled and free market area once offered great opportunities for arbitrage and illegal movement of goods from the cheap planned sector to the higher priced market one. These price differentials have diminished as the market expanded and the prices of raw materials and goods from state operated enterprises have been increased. However, the rapid development and extension of the market sector has brought new problems into existence. Dishonest behaviour is particularly prevalent in real estate, the securities industry, and future markets. China lacks a full set of laws and rules, while what it has are often ill-framed and unclear. It is weak on property rights, has no means of ensuring that those involved in corruption are exposed, and often lacks the will to deal with problems of corruption where it involves high-level people.

In order to demonstrate that it takes the problem of corruption seriously and is determined to stamp it out, the authorities took the highly unusual step of charging Chen Xitong, a member of the politburo, leader of the Beijing Communist Party and a former Mayor of Beijing, with corruption. He was

placed under house arrest in April 1995 but it was not until July 1998 that he was tried in court and found guilty of misappropriating public funds and illegally accepting gifts valued at some 39.2 million yuan (\$4.7 million dollars). He was sentenced to 16 years in jail. As a leading Party figure, he is also believed to have been involved in a series of scams amounting to a further \$2.2 billion. Ordinary people routinely receive the death penalty for embezzling tiny sums, but Chen Xitong was let off lightly. It is believed that he knows much about the financial and sexual peccadilloes of numerous other high officials. Many in Beijing believe that he did a deal, his silence in exchange for no death penalty, and he was treated leniently. Greed and corruption seem to have been a family interest: in mid 1997 his son, Chen Xiaotong received a 12 year jail sentence for embezzlement and accepting bribes.

In 1998, state grain purchases were revealed to be a major area of corrupt activity. A team of auditors discovered that loans to buy grain over a six year period amounted to \$65.6 billion, but the total stock in grain depots was worth only \$39.8 billion; 37 percent of the missing money had been diverted to buy shares, cars and mobile phones, and the rest went to buying high and selling cheap or corruption.

To help combat the growing corruption, some 3,600 watchdog offices have been set up since 1988, but so far they have not managed to put a dent in it, let alone demonstrate that they have the ability to eliminate it. The Party is antagonistic towards other possible centres of power and wishes to keep all anti-corruption efforts firmly under its control. In October 1998, the leader of Corruption Watch, an unofficial group with members in fourteen provinces, was questioned for seven hours before being released and warned to stop his activities.

Prostitution has returned to China and has become widespread, operating from venues such as five star hotel foyers, down through karaoke halls and hairdressing and beauty salons, to massage parlours. It is a growing social problem and can be expected to increase the spread of HIV cases. These are estimated at 300,000 in 1998 and forecast to reach a million by the turn of the century.

The official one-child family policy has encouraged the abandonment or killing of female babies and the use of modern technology to determine the sex of a foetus. Females may then be aborted. As a result, there is a gender imbalance in China, with 118 male births to 100 female births, compared with a global norm of 104 male births. A shortage of suitable female marriage partners has already emerged, partially the result of wealthy rural entrepreneurs demanding city brides; the consequence has been the emergence of a small industry that kidnaps young women to sell as brides to the *nouveau riche*.

Particularly in the coastal cities of China, some wealthy businessmen from Taiwan and Hong Kong have set themselves up with mistresses, whom they house and keep in luxury. This is difficult for the government to tackle, partly because they probably sympathise with what was a traditional practise of having several wives or concubines, and partly because they do not wish to antagonise a major source of foreign investment. Local wealthy businessmen in urban areas also enjoy the habit.

Since 1978, the deluge of migrant workers into cities has caused social problems and placed pressure on urban infrastructure, but it was not until 1992 that the tide reached a flood. It has proved impossible to provide housing for them, so that they are often forced to sleep rough, in railway stations, building sites or anywhere they can. The public transport has also been placed under strain and beggars have proliferated. Hundreds of migrants hang about seeking work, often exhibiting a tool of their craft, if they have one, in the hope of attracting an employer. Local regulations often prohibit them from working in the better jobs: Shanghai has declared that illegal residents (all of whom are migrants) cannot work in management, financial services, run taxis, become shopkeepers, telephone operators or security guards. They are restricted to those jobs that are avoided by the local residents, which are usually dirty, hard and badly paid. Yet a peasant can still earn considerably more than back in the fields – if he can get a job. The majority of the floating population is male.

They are unpopular with official residents, and automatically suspected of any minor crime that occurs in the vicinity. In 1995, many cities began to tighten up on movement but the problem of what to do about the unemployed migrant workers remains.

The increased incomes both in and outside agriculture have led to changes in the patterns of consumption. In rural areas, the peasants have spent much of their surplus building new houses. There is a tendency to invest shrewdly, and if a family moves into its new house, the old one may be used for animal shelter or rented out. Local governments have also gone on construction spending sprees, sometimes for new buildings, often for roads, and occasionally for economic development zones.

In urban China, washing machines were effectively unknown before 1980, but have since become common. Most families now own a radio, tape recorder, washing machine, stove or cooking range, a steam iron, bicycles and one or more electric fans. The ownership of other desirable goods is low in 1998, standing at personal pagers (15% of urban households), motorcycles (14%), VCRs (12%) air-conditioners (6%) and mobile telephones (4%). Mobile phones have become a major status symbol for those with power, influence and money. One in four urban families owns both a telephone and a refrigerator.

Newly married couples have always had a set of "Four Items", which are highly desired. A few short years ago it was a basic list, consisting of watches, bicycles, sewing machines and clothing. With rising living standards and aspirations, the list now reads: refrigerators, TV sets, washing machines and video players.

Urban single children, who are widely regarded in China as spoiled and often referred to as "Little Emperors", tend to have items like electric toys and computer games lavished upon them. Any company dealing in these high demand goods tends to do well. These Little Emperors may become a serious social problem for the future, as they grow up expecting to be spoiled and doted upon.

People are living longer, and the problem of taking care of the elderly is steadily worsening. Some families are already refusing to take care of their parents, a remarkable change from the traditional Confucian values. The numbers are not small and are increasing: in 1997 there were 8 million people aged over the age of 80 years; by the year 2050, it is estimated that there will be 160 million over that age. The one child family policy will result in a bulge at high levels of the population pyramid and place increasing pressure on family and state to care for the elderly.

The Chinese have traditionally eaten a lot of vegetables, but from the necessity of poverty rather than choice. With the rise in incomes, chicken and pork have become reasonably common in the diet, as have eggs and even milk. Until recently, milk was restricted to invalids and the families of high Party officials. Western fast food has made an appearance in the cities in the past few years, and despite being expensive by local standards, has been remarkably successful. Domestic tourism is on the rise, and even visits to foreign countries are now possible. In short, China is in the process of doing a lot of catching up with the consumer preferences and habits of the outside world, from which it was deliberately excluded by its leaders for several decades.

The rapid economic development has begun to put pressure on existing social values. The threat of social unrest, although still small, is increasing. The growing unemployment, which is expected to worsen as policies on SOEs begin to bite harder, is already a matter for concern. Worker protests, strikes, sit-ins or demonstrations have already occurred in places such as Beijing, Xian, Shenyang, Wuhan, Changsha, and Anhui, protesting unemployment and unpaid wages. The demonstrations are expected to widen as the policies to increase efficiency intensify. Reducing wages, sometimes to half, possible in an effort to maintain employment levels, has also led to demonstrations in Wuhan.

Even the peasants have demonstrated, usually about not being paid for crops delivered to the state, or for land requisitioned by the government. Some used the classic method of shaming the authorities into paying for land taken from them for building purposes: in Hunan province, hundreds of them knelt facing the government buildings for two hours – and won! The provincial government agreed to pay, but allegedly only one quarter of what had been promised.

Ironically, at the same time as the introduction of new ideas, there has been a noticeable resurgence of some more traditional values. The Maoist vision attacked and reduced the level of feudal attitudes, but the economic growth and development of newer views have eroded the communist values built up between 1949 and 1976. The new freedoms introduced since then have allowed more traditional values to resurface. These include Confucian family-centred thinking, which the communists had never managed to eradicate, and Buddhism, together with a variety of feudal superstitions and practices, including belief in magic, witchcraft and shamans.

Among ordinary people, there is still a feeling for the group, and the sense of community is still strong. People tend to keep an eye on each other's behaviour, more so than in most Western cities, although it is less than in the Maoist era.

## **The Long View**

In an historical perspective, China is still seeking a solution to the questions first asked after the ignominious defeat at the hands of the British in the First and Second Opium Wars, 1839-42 and 1856-60. These questions included what were the best ways of dealing with these technologically advanced if barbaric foreigners, and how to modernise China without losing Chinese social and cultural ways. These are universally regarded in China as superior to Western values. Whether China will eventually find a solution, and what this might be, is still unclear.

China has been in a transition period since 1978, when it began to move from a centrally planned to a market-based one. China adopted a gradualist approach to this, and so far has generally been successful. There is often a process of moving "two steps forward, one step back", which involves pushing forward as long as things are going well, then retreating as and when problems start to emerge. After a pause for consolidation and problem tackling, the forward movement is resumed. The actual changes are often experimental in the first case, with several different methods being tried out in different parts of China and then the best one being selected for widespread adoption.

The major current concern is how to cope with the millions who are already unemployed and the many more millions who will become so as a result of trying to continue the restructuring of the inefficient centrally-planned economy. Social pressures have already increased and the potential for political unrest is growing. All this is taking place in the context of the 1997 Asian financial crisis, a slowing of the economy, weakening hopes for export growth, and a loss of foreign exchange. The foreign exchange reserves are still large, however, at around \$140 billion in February 1998. China has sworn many times that it will not devalue the *yuan* and almost all observers feel it will do its best to keep its word. The temptation to run another domestic economic boom is great, but this could slow the reform process and create new inflation. China keeps prodding Japan to do more to lift Asia out of its slump and certainly in the short term, Japan could increase the level of domestic demand and reflate its economy. In the longer term, there is need for a complete restructuring of its administrative structure, a change in management practices, and open up to greater foreign competition.

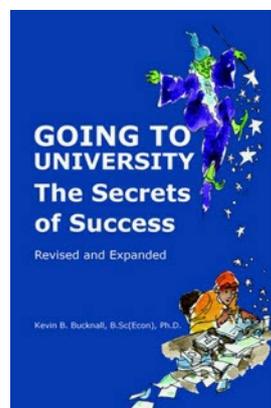
The biggest question, still to be answered, is whether or not it is possible to run a country successfully with a communist government in charge of a capitalist economy. To many Westerners, it seems an obvious contradiction and they believe the attempt must fail. This school of thought sees successful

economic growth as inevitably increasing the pressure on a dictatorial regime, until ultimately personal freedom must be allowed to increase, and the result will be something approaching a Western democratic system. Such observers feel that the main historical question, about what sort of China will be chosen, has now in fact been answered. It will be a Western-style democracy, and this, in the words of the developers of computer vapour-ware, will appear “real soon now”.

This view may reflect Western cultural and political bias, and some observers, although now a minority, suspect that the end result in China, and perhaps other Asian nations, might not resemble a Western democracy. Instead, such nations might favour a sort of benevolent Confucian system, in which there is no real place for an opposition party, except perhaps a powerless nominal one as a sop to the disaffected and the intellectuals. The 1997 Asian financial crisis and the events in Indonesia, which culminated in the fall of President Suharto, have recently muted the proponents of this view and it is not currently well regarded.

**The author's *China and the Open Door Policy*, originally published in paperback in 1989 was republished as an E-book by Boson Books, North Carolina, in 2012, ISBN: 9780917990724. It is priced around \$7.99.**

**The author's latest book is *Going to University: the Secrets of Success*, 2nd Revised and Expanded Edition, Kewei Press, UK, 2009. The recommended retail price is £9.95. An excerpt can be downloaded from [www.keweipress.com](http://www.keweipress.com) A Kindle version is now available, priced about £3.09 (inc. VAT), or in United States dollars around \$4.79. Details and links on the site below.**



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