Commentary Online

The End of the Chinese Miracle?

Gordon G. Chang From “COMMENTARY” March 2008

In his recent book, The Age of Turbulence, Alan Greenspan identifies the only nation that, in his view, can challenge the United States for world economic leadership a quarter-century from now. That country is China. Yet by each of the criteria that Greenspan himself considers crucial to economic success—property rights, representative governance, and the rule of law, to name the most important—China scores poorly or worse. Thus, the question raised inadvertently by Greenspan’s book is whether China’s effort to overtake the dominant position of the United States in the world economy can continue to coexist with the country’s overall political framework.

So far, China’s performance alone would seem to vindicate Greenspan’s prediction. Since Deng Xiao-ping’s ascension to power in 1978 and the beginning of the period of economic reform, the Chinese gross domestic product (GDP) has grown at an average annual rate of 9.8 percent according to official statistics. What is more, the rate of growth seems to be accelerating. Official indications are that GDP jumped by 10.2 percent in 2005, by 11.1 percent in 2006, and by 11.4 percent in 2007.

Astonishing figures like these have led the economist Jeffrey Sachs to declare China “the most successful development story in world history,” and Bill Gates to predict that the Chinese economy will overtake ours sooner rather than later. What is more, China’s economic success is now seen to be a result of its unique mix of totalitarian and authoritarian policies—policies that are at the heart of the so-called “Beijing Consensus.” Whereas conventional wisdom holds that, in the words of the China expert Andrew Nathan, “authoritarian systems are inherently fragile” and inimical to prosperity, “this particular authoritarian system . . . has proved resilient.”

Will it continue to manifest such resilience? China’s Communist party has

created growth by grafting free-market mechanisms onto a Marxist structure—an experiment with few parallels in history. It has done so mainly by means of its decades-long program of gaige kaifang, “reform and opening to the outside world.” The growth we see today is in most respects the payoff from that earlier reform. But what about tomorrow? Can China’s current political system undertake the further reforms necessary to move forward? And if not, what then?

After seizing control of China in 1949, Mao Zedong nationalized the country’s industry, collectivized its agriculture, built a Soviet-style command economy, and nearly destroyed China twice—once starting in the late 1950’s with the Great Leap Forward and then again during the decade-long Cultural Revolution, which ended with Mao’s death in 1976. Although his successors mostly agreed on the need to modernize the rigid economy, they could not come together on how. Progress arrived only when Deng Xiaoping grabbed power from the now-forgotten Hua Guofeng and built a coalition that sponsored tentative reforms, first in the countryside and then in cities. What the party would not or could not do, the Chinese people proceeded to do on their own, often implementing change ahead of Beijing’s cautious technocrats and retrograde ideologues.

No great reformer in history has been able to control the pace and progress of change, and not even Deng, a clever and wily man, was an exception. He lost his grip in the late 1980’s as inflation fueled discontent and discontent fueled larger and larger protests, notably in the capital. A believer in economic experimentation, Deng was no experimenter in politics: he insisted on maintaining the party’s absolute monopoly on power. Nor, at least initially, did the protesters during the “Beijing Spring” of 1989 challenge this point. But they did exhibit an assertiveness that was inherently threatening, and the result was a massacre in Tiananmen Square that horrified the world.

Tiananmen brought home to Deng the simple truth that, if the Communist party

meant to continue to rule China, it had to engineer an enduring prosperity.
After two years spent weathering the world's indignation, he made rapid reform the official policy of the party. As he put it, "Slow growth isn't socialism."
Today, China does not have slow growth. Many foreign observers believe it does not even have socialism. "It's capitalism at full speed," averred Bill Gates at Davos in 2004. But Gates is wrong. The Chinese economy has indeed been moving at full speed, but it is by no means a free-market economy. Instead, it is guided and sometimes controlled by tens of thousands of central and local government technocrats who, among many other things, determine the prices of crucial inputs (for instance, land, labor, and energy), fix final consumer prices, and administer a gigantic program of manufacturing subsidies.
The technocrats also manage the large, state-owned enterprises that control such "pillar industries" as automobiles, telecommunications, steel, and petrochemicals. Encouraging foreigners like Bill Gates to provide capital, technology, and know-how to help rejuvenate state industry, they have worked no less hard to keep control in the hands of the state. At the same time, they mostly restrict domestic Chinese entrepreneurs to smaller-scale businesses that are considered nonessential.
"Socialism with Chinese characteristics"—another Deng phrase—has thus turned out to be a fragmented system, with distinct economies existing side by side. There are several private sectors, all of them vibrant, and a large state-owned one that after three decades of almost constant restructuring is only semi-reformed and has compiled a lackluster record at best. Even though the state sector has a call on about 70 percent of the loans in the banking system and almost exclusive access to the equity and debt markets, state enterprises produce only about a third of China's non-agricultural output. The stunning growth numbers issued by Beijing's National Bureau of Statistics are essentially averages, produced by superheated private-sector output weighed down by mostly mediocre state results.
If it were not for monopoly profits and government spending, state-sector growth

would be even less impressive.

In brief, the party's insistence on retaining a socialist framework for the Chinese economy has, if anything, held the country back. As the Financial Times columnist Martin Wolf observes, Chinese growth has been markedly slower than that experienced by Japan, South Korea, and Taiwan in their initial expansionary phases. China could have—and should have—done better.

In the meantime, and whatever the final economic balance sheet may reveal, it is undeniable that the party's economic restructuring has had a profound effect on Chinese society. With very few exceptions, peasants no longer slave away on collective farms but work their own plots and are responsible for their own livelihoods. Workers, even those employed by state enterprises, are rarely cocooned in company towns, as they once were. Most importantly, the old mechanisms of social control, epitomized by work-and-neighborhood units that monitored and directed virtually every detail of daily life, have largely lapsed. By now, Beijing has gone to the opposite extreme, dismantling the cradle-to-grave social system that was the hallmark of Maoism; the Chinese government now provides far fewer social services than do most Western democracies.

True, the state still exercises restraints on its citizens' behavior, but many of these, too, are flouted, including the hated one-child rule and the bans on various forms of student dancing. And although Beijing still censors, imprisons, and intimidates, it is engaged in a struggle in which it can never claim final victory. In the words of Robert Suettinger, who served in the Bush, Sr. and Clinton administrations, China's leaders "are struggling to keep up with a society that is changing in a direction and at a speed they cannot fully control."

The party's loss of control over the Chinese people—the direct result of three

decades of economic change—has led to insecurity and fearfulness in the senior leadership. And this fear, in turn, has resulted in a pronounced slowdown in the pace of economic reform, first noticeable during the tenure of Deng's successor Jiang Zemin and more evident today under Hu Jintao. According to the analyst Minxin Pei of the Carnegie Endowment, the government is in a "trapped transition," or a "partial reform equilibrium." Although officials announce economic adjustments almost daily, many of these, especially the new restrictions on foreign business imposed during the last year and a half, can hardly be considered reforms. For the rest, the government is only tinkering and marking time.

It can afford to do this thanks to a sweet spot of growth in the economic cycle. This began in 1998 when Zhu Rongji, Jiang's premier, embarked on a massive government spending spree in an attempt to grow China's way out of what Zhu called an impending "collapse." That fiscal-stimulus program continues to this day. Last year, state spending accounted for about a quarter of the total official economic output.

This cannot go on indefinitely. No government, China's least of all, can efficiently direct the use of capital over time. As more and more yuan chase fewer and fewer viable opportunities and produce less and less growth, Beijing's fiscal stimulus has become progressively wasteful. It has also severely aggravated already existing imbalances. Beijing's debt is about three times the internationally recognized alarm level of 60 percent of GDP, and the government is constantly adding to the amount. Today, for instance, there may be as much as $1.2 trillion in bad and questionable debt, much of it undisclosed, on the books of the state banks and the central government.

Beijing is also manipulating the value of its currency. Until July 2005, the central government pegged the yuan to the dollar to obtain a trade advantage for China's exports. Now it permits a heavily managed float, the result of which has been a massive influx of foreign currency. When converted into yuan, this has

led to unmanageable increases in the domestic money supply, causing runaway inflation and the recent stock-market and housing bubbles. Last year's inflation rate, preliminarily estimated at 4.8 percent, was the highest since 1996, and the official figure is undoubtedly understated.

The obvious alternative to these distorting policies, and the only path to enduring prosperity, is to pursue genuine reform. It is unlikely, however, that the Chinese government can or will take that route. The reasons are various. For one thing, establishing a true market economy requires the rule of law, which in turn requires institutional restraints on government. Yet the Communist party insists on remaining above the law. Senior leaders are fond of talking about rule by law and, more bizarrely, rule of virtue; both are incompatible with the establishment of the institutions necessary for a modern economy. Another thing that makes reform exceedingly difficult is the corruption that infests Chinese society and officialdom. The party has been trying to fight this cancer for decades, yet despite a seemingly endless series of show campaigns, it has proved utterly incapable of stemming bureaucratic and political graft. There will be progress only when two unlikely things happen. First, independent prosecutors must be able to pursue senior officials and try them in impartial courts—something that will not occur so long as the party refuses to subject itself to the rule of law and the supervision of the ballot box. And second, the tollgate position in the economy occupied by bureaucrats must be eliminated, something that these newly rich apparatchiks have so far been able to prevent. The late party statesman Chen Yun perfectly summed up the fundamental dilemma in this area: "Not fighting corruption would destroy the country; fighting it would destroy the party." China has made its choice. As the plague has worsened, especially under Hu Jintao, reform has slowed; as reform has slowed, the plague has worsened.

Nor is the party capable of carrying out another necessary reform: eliminating the role of state enterprises. In the past, Beijing sold off, merged, or closed tens of thousands of these businesses. Now it has announced plans to shrink the number controlled by the central government from 152 to as few as 80 by 2010. Yet, at the same time, it is stepping up its efforts to turn the remaining enterprises into “national champions,” with dominant market positions in their respective industries, and it is increasing its ownership share in them.
Last year, the official People’s Daily reported that the government would assume “absolute control” of seven “lifeline” industries. In August, Beijing’s newly formed sovereign-wealth fund, China Investment Corp., indicated that it would probably spend some of its $200 billion to buy stakes in at least sixteen large firms. And, in still another instance of re-nationalization, the Social Security Fund has been investing increasingly larger portions of its assets in publicly listed stocks of domestic enterprises. The numbers of state-controlled industries may or may not shrink; the degree of state control seems set to rise.

Will the party compensate by tolerating more development of the various private sectors? That too appears unlikely. After opening its doors to domestic entrepreneurs a half-decade ago, Chinese leaders have become fearful of their growing economic power and have increasingly discriminated against private domestic and in favor of foreign sources of capital. The party has also systematically inserted its operatives into non-state businesses, creating cells that now claim three million private-sector members.
For all its organizational efforts, however, there is little evidence that the party has gained much influence over this sector. Moreover, there has been virtually no party penetration of China’s numerous underground businesses. In short, the party now has little ability to manipulate the healthiest parts of the economy to its advantage.
But the fundamental problem is this: the party is attempting to reform a system

that is essentially unreformable. “If you are going to have socialism, then as a matter of principle you can’t have a free market,” notes Singapore’s Lee Kuan Yew, otherwise known for his admiration of Beijing-style development. Socialism, as Joshua Muravchik has shown in Heaven on Earth, has never worked well for more than a generation in any community, large or small. After three decades of change, almost all the easy reforms have been implemented in China. Most of the remaining ones, if seriously undertaken, would spell the downfall of the regime, and for that reason alone the party will not and cannot put them in place.

Speaking about Soviet Communism in the early 1980’s, Ronald Reagan observed that “what we see here is a political structure that no longer corresponds to its economic base, a society where productive forces are hampered by political ones.” The same applies to China today, in spades. Because Beijing cannot confront the gap between politics and economics, it cannot tackle difficult problems, take on vested interests, or force structural change. Nor can it speak plainly to the Chinese people or even discuss matters candidly within its own ranks. As Zhong Dajun, a Beijing economist, has written of the resulting paralysis: “These are problems that are too important to avoid but too sensitive to face up to, so they are dealt with by vagaries.”

And China certainly has no shortage of tough problems. One pressing problem is its need of approximately $1 trillion to fund social-security obligations—a figure that does not include the cost of education, health care, or any of the other essential services that the central government no longer provides. Another is the fallout from the toy, toothpaste, and tire scandals, in response to which the party flailingly imposed death sentences on a few unlucky officials, jailed reporters, levied retaliatory bans on imported items, and declared with a straight face that its four-month “special war” against dangerous products and food was a “complete success.” Still another problem, perhaps the most difficult

Beijing confronts, is the severely degraded environment, the horrific manifestations of which have provided much fodder for Western journalists covering preparations for this year's Olympics.

All of these problems are the byproducts of economic growth. None can be systematically addressed, because the party fears that doing so would slow an economy whose momentum—now that Communism itself is a creed that no one believes in—constitutes the main basis of its legitimacy.

The irony is that, in some ways, the challenges now facing China are less difficult to surmount than those of the past: the famine during the Great Leap Forward, the chaos of the Cultural Revolution, popular resentment following the butchery in Tiananmen Square. Yet there is a critical difference between those times and these. For better or worse, China's former leaders, especially Mao and Deng, were capable of great boldness. Today, the lifeless officials who populate China's bureaucracy are the products of a system specifically designed to prevent the emergence of a potential Mao or Deng, let alone a budding Mikhail Gorbachev—the Soviet leader whom Beijing blames for Communism's collapse. In their obsession to avoid a USSR-type disintegration, the nine men who run China from their perch on the all-powerful Politburo Standing Committee have ensured that only Brezhnevs, Andropovs, and Chernenkos will succeed them.

From the fall of the Soviet Union, China's leaders have gleaned the lesson that reform must be undertaken very slowly lest it shock the system beyond repair. But the real lesson of the fall of the Soviet Union is otherwise—namely, that when necessary reform is delayed too long, radical political transformation becomes all but inevitable. China, as Harvard's Ross Terrill has observed, can drive off the cliff at slow as well as at full speed.

At some level, China's leaders understand all this. Last March, Premier Wen Jiabao used "four uns" to describe the Chinese economy: "unstable, unbalanced, uncoordinated, and unsustainable." He deserves credit for saying it out loud.

But then, instead of taking action, Wen and Hu Jintao largely retreated into the

sloganeering of the past. They are now in the midst of a long-term campaign to revive the reputation of Mao Zedong and the vocabulary of Marxism. The "scientific outlook on development," a nonsensical concept, has been written into the party's charter at Hu's insistence, and "harmonious society" has become the latest buzz term—signs of a political leadership that has run out of ideas and can now only futilely demand obedience from an increasingly restive citizenry.

Westerners dazzled by China's economic growth tend to ignore such ideological straws in the wind. But the next chapter in the history of the Chinese people is being written, and it is bound to upset many a confident assessment of the country's present and many a grand prediction of its future.

About the Author

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