China's "Transition Under Communism"

LOUIS PUTTERMAN

Professor of Economics at Brown University

China's record of rapid growth since the onset of economic reforms in 1978 has been widely noted. According to Shahid Yusuf of the World Bank, China's gross domestic product has grown at 9 percent per annum rate since 1979, a performance that is "among the highest on record."[1] China's rapid economic growth is especially noteworthy in an era in which the industrialized economies grew slowly, and in which the transition from centrally controlled to market economies caused painful declines in living standards in central and eastern Europe and the former Soviet Union. China's 8 percent rate of *per capita* annual income growth, for the 1980s, contrasted with essentially zero growth by middle income economies and with 2 percent growth rates for other low income countries, as a group. Among all other countries, only the Republic of Korea surpassed China's growth rate during this period.[2]

Making a point sometimes overlooked by market enthusiasts, Yusuf notes that "China has been able to assimilate new practices faster than many other developing countries because of accumulated industrial learning...starting in the early 1950s."[3] But an appreciation of the industrial foundation bequeathed by the old state-centered economy does not prevent Yusuf from identifying the main cause of China's extraordinary post-1979 record as the country's economic reforms. An assessment of both China's pre-1978 industrial push, with its anti-market bias, and China's post-1978 reform process, with its clear market orientation, is required for an understanding of the country's recent achievements.

A lively debate goes on in the socialist reform field on whether China's economic successes, and the contrasting hardships of ex-Communist Europe and Russia, is an indication that a "gradualist" reform path is better than a rapid transition ("shock therapy"). Closely related is the question of whether China's successes are reflective of the possibilities of a "reformed" or "market socialism," or simply of the increasing importance of non-socialist enterprises in its economy. These issues will be visited below.

Finally, will China's successes continue, and where is the country headed? I will venture some brief speculations on these issues before concluding.

China Under Mao

China's is an ancient civilization with a commercial culture dating back at least a thousand years. During Marco Polo's travels in the thirteenth century, and until well into the fifteenth or sixteenth century, commercial and technological development in imperial China surpassed that of a politically fragmented and culturally benighted Europe. But China's internal stability and its supremacy in east Asia made it cling to stasis while the West developed, and Japan prodigiously emulated, a new form of economy and polity. The empire's inability to defend its sovereignty finally led to its overthrow and to the growth of competing nationalistic and developmentalist movements.

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Marxism came to China, as to other "backward" countries, as a theory of economic development and national resurrection. By giving centrality to industrialization and at the same time indicting the West's social system, it appealed to modernizers who wanted to emulate European technology but reject the values of a colonizing culture. Contrasting Russia's impressive industrial progress with the West's depressed economies in the 1930s, those attracted to this outlook could also readily convince themselves that its approach to development was not only a viable, but also a surer route to national resurgence. Finally, Mao Zedong and comrades used the *egalitarian* strain in Marxism to appeal to their country's rural masses and thereby to attain power and impose their form of unity on a nation weakened by decades of strife.

In many ways, China copied the Soviet story of rapid industrialization in the three decades following 1949. Savings, which averaged only 5 percent of national income during the 1930s, rose to over 15 percent in the mid-1950s and to some 30 percent in the 1970s. Industry, which accounted for only 30 percent of agricultural and industrial output value in 1949, produced 57 percent in 1957 and 74 percent in 1978.[4] Agricultural output grew at a rapid enough pace to feed an additional 420 million mouths, a number exceeding the current population of Western Europe. China fostered a home-grown green revolution in agriculture, became a nuclear power with missile and rocket-launching capacity, and raised its people's life expectancy from thirty-two to sixty-five years.

China was also a socialist country with a twist. As a poor Third World country with a large rural population, it was frequently compared with similar countries and oft-times praised for its combination of growth and equality. And its leftist leadership developed a distinctive ideological line, making China a beacon to idealists who contrasted the Soviet Union's brand of hierarchical, materialistic, industrial society with China's emphases on cooperation and equality. With much of China's bureaucracy ousted for "putting economics over politics," planning was devolved to local levels, and the economy was coordinated by improvisation. And China "walked on two legs," complementing Soviet-style heavy industry in the cities with small scale industry in the countryside.

But the picture was far from all bright. Although China's per capita growth rate of some 4.5 percent a year was above the average of developing countries, growth in output was achieved at the expense of consumption; equally high growth rates should have been possible with a lower level of investment. Away from the model communes shown to Western visitors were hidden significant pockets of poverty, with some 100 million rural residents estimated to be consuming under 1500 calories a day.[5] And to a generation of potential leaders languishing in the countryside, factories, and prisons, the idealistic slogans of Chairman Mao were tools cynically deployed in a struggle for power, not a genuine philosophy to live by.

The Second Revolution: The Pragmatists Ascend

From the 1950s to the 1970s, Communists who placed a premium on economic growth struggled with Maoists for control of the Chinese state. Seeing no future among the leftists, Mao's compromise successor allowed pragmatic and orthodox forces to arrest their leaders within a month of the Chairman's death in 1976, and the extreme Maoist line disappeared from China's political stage. The remnants of the old

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A nationalist above all else, Deng compared China's progress to that of capitalist Taiwan and Hong Kong and judged that old verities about the superiority of planning could no longer stand. To make sure that leftism would not resurface, he delivered two decisive blows, first, permitting certain truths about their relative economic standing to be shown to the Chinese people, and second, altering prices, wages, and production priorities to deliver a rapid (and much delayed) improvement in their material consumption standards. With mass support for reformism assured, Mao-lovers could fume as they liked in Paris and Peru, but Mao stayed safely embalmed in Beijing.

The supremacy of the pragmatists in economic matters, however, called for more victories on the battlefield of policy and ideas. To be "top cat" in China, asserted Deng, you've got to catch the mice. Agricultural reform did just this. With the government freeing some crop prices, allowing peasants sell produce directly to city folk, opening a wide range of non-farm enterprise to be pursued by rural dwellers, and permitting the communes and their sub-units lease their land to individual farm families, output jumped by 48 percent in seven years. China's 800 million rural dwellers, whose incomes quickly doubled, were enthusiastic, while the more Stalinist of China's leaders were rendered speechless before so effective a cat.

Although agriculture's stunning growth spurt rested on a foundation of technological modernization, including a massive increase in chemical fertilizer consumption and the breeding of more productive seed varieties, it was the increased incentives offered to Chinese farmers that released the genie from the bottle. Before long, reformist provincial leaders were experimenting with ways of repeating the miracle in their industrial sectors. Deng plucked Zhao Ziyang from the vanguard of provincial reformers to direct the new reforms from Beijing.

Long before, skeptics of socialism had argued that the efficient economy is the one that effectively harnesses the information of "the man on the spot," giving him rewards for acting upon it and minimizing the need to pass messages up and down a hierarchy.[6] Socialist reformers adopted this idea as their own, arguing that enterprise managers should be given more autonomy, and more rewards for exercising it. The problem, however, was that this strategy made sense only if other fundamentals of the Soviet-type system were abandoned. Rewarding profitable enterprises will not spur efficiency as long as profit and loss result from fortuitous or unlucky configurations of state-set input and product prices. Hence, prices must be restructured—or freed—to reflect input scarcity and product demand. If competition is to work, losers must be penalized as surely as winners are rewarded, but this means letting loss-making enterprises be shut down and forcing their workers to search for employment elsewhere. But abandoning planning and controlled prices will not only threaten the roles of the economic bureaucrats and the doctrines of their political patrons, but also drive a stake through the heart of the twin guarantees of job security and stable prices.

Since radical reforms promised few immediate benefits to the heretofore protected state workforce, urban reform proceeded cautiously, with enterprises retaining some profits and conducting some trade at uncontrolled prices, but with job security and benefits preserved, and with continuing subsidies to loss-makers. Yet all around the state sector, radical change was occurring. Those not already under state employment were told to find their own jobs, if necessary by starting private businesses. Trade in services and consumer goods enlivened the urban markets. And foreign companies began operating in special economic zones and elsewhere, spreading technical standards and organizational methods to other parts of the economy. Whereas the state and urban collective sectors produced 90 percent of China's industrial output in 1980, their combined share fell to 60 percent in 1992, with the state sector's portion by itself falling from 76 percent to 48 percent of output. Rural enterprises were especially dynamic, raising their shares of industrial output and employment to 25 percent and 39 percent, respectively, and producing 24 percent of China's exports, in 1990. The overall value of China's exports shot up from 13.7 billion dollars in 1979 to 84.9 billion dollars in 1992, repeating the earlier export growth of east Asian neighbors.

Capitalism or Socialism?

Not only would central planning fail, said the skeptics of socialism, attempts to reform the system without making assets private would also fail, because enterprises assured of being kept afloat would raise employee compensation and investment more surely than they would raise efficiency.[7] Do China's successes belie this prediction, or are they due instead to the advent of capitalism under the thin disguise of "socialism with Chinese characteristics"?

By 1994, China's economy was largely a market economy, in the sense that the prices of most goods were determined by buyers and sellers, and that most production decisions were made by enterprise managers, not by planners. But it would be straining matters to call that economy capitalist. As Gary Jefferson and Thomas Rawski write, "[t]he contribution of genuinely private firms, although difficult to measure, is in the vicinity of 10 percent [of output]."[8] In rural areas, establishments owned by township and village governments—the former communes and brigades—still accounted for 50 percent of enterprise employment and for 65 percent of enterprise output in 1990.[9] Farmers, while growing and harvesting their crops household by household, farmed land formally owned by their villages, and in many cases the villages established crop rotations and provided plowing and other services. Between them, state, urban collective, and township and village enterprises produced 84 percent of output in 1992.

Ownership, on the other hand, is not a one dimensional characteristic, but rather a bundle of rights and obligations. "State ownership," which in the 1970s gave government organs the right to determine employment, input assignment, and production, the obligation to cover costs, and control of net earnings, is today so attenuated that one expert suggests modeling state firms as entities controlled by self-interested coalitions of managers and workers.[10] Such public ownership prerogatives as still exist reside more often in provincial and municipal bodies than at the national level, with the strictness of fiscal discipline arguably inversely related to the scale of the relevant jurisdiction. Nominal township or village government ownership covers a substantial range of cases, with some involving direct local government control, others leasing to managers who enjoy considerable autonomy, and still others entailing essentially private ownership with formal protection by a township or village "cap." The degree to which elements of the conventional bundle of rights we call ownership resides in public bodies remains great in China, but it has been on the decline.

China's economy remains "socialist" in other respects. Most urban workers obtain housing from their work units for which they pay only nominal rents. Until very recently, at least, state sector jobs were secure, in many cases even heritable. Medical care is free or highly subsidized. The government steps in when price rises on basic foodstuffs are considered too steep. And there are the familiar negatives, including low standards in housing, hospitals, and environmental regulation, the prevalence of bribery in the face of rationed services and goods, and the absence of political freedoms, including worker rights to organize and to strike.

Where is China Heading?

A few years ago, it was commonplace to look at semi-reformed economies, such as that of pre-1989 Hungary, and to conclude both that "market socialism" is an oxymoron, and that the transition to a market economy cannot be completed under a Communist regime, with its inviolable commitments to secure jobs and price stability. This outlook at least in part underlay resolve to carry out the most rapid possible transitions after Communist governments stepped down in Europe in 1989 and in the Soviet Union in 1991, and some saw it as vindicated again when hard-liners temporarily gained ascendance following the suppression of anti-government protests in China in 1989. With the reform movement's resurgence and its scaling of new heights in China over the past three years, and with the return of China's economy to double-digit growth after a cooling-off period during 1989-91; however, the validity of these beliefs has now come into question.[11]

Whereas in the late 1980s, it was an open question whether China would succeed in becoming the first country to complete a transition to a market economy under Communist rule, it seems reasonable today to conclude that China will almost certainly complete such a transition; one merely wonders whether the transition is not already largely complete. With most economic transactions occurring at prices determined by the agents involved and influenced by conditions of supply and demand, the degree of government intervention in Chinese resource allocation comes ever closer to that of relatively interventionist market economies such as France or India. In hindsight, the supposed improbability of a market transition "under Communist rule" was in large part due to the illusory conception of an immutable doctrinal core in any party calling itself Communist. Whereas there probably were rather rigid ideological constraints on the government of Hungary so long as it operated under the Russian shadow and Moscow remained under the control of orthodox Communists, this was not so for the autonomous Communist Party of China, the doctrines of which could change with the composition of its leading echelon. Given that leaders were willing to label as "socialism with Chinese characteristics" just about anything conducive to economic growth, the party could choose to call itself Communist indefinitely, yet be well on the way to becoming a dispenser of much the same sort of authoritarianism plus state-sponsored growth as had become the norm throughout the east Asian neighborhood.

While the possibility of a market transition "under Communism" thus appears far less implausible today, whether "market socialism" is a contradiction in terms is a question that is not as easily resolved, and one to which China's progress may offer only the most partial of answers. One might freeze the frame of the moving picture that is China, make a plausible case that its current institutional mix is "market socialist," and proceed to analyze the viability of those institutions, to see how market socialism stacks up. Since this society is achieving rapid economic growth and turning out billions of dollars worth of export-quality consumer goods in factories owned by governments of varying levels, and with market forces as its main coordinating mechanism, its performance makes market socialism appear to be not only possible, but even favorably comparable to the institutional regimes of many other societies.

But China's society is in motion, and today's institutions appear destined for the history books as surely as the people's communes and factory revolutionary committees of earlier decades. Even if market socialism is a viable option, it seems to have no real constituency in China, but rather is the result of a temporary truce between conservative and reform forces, a way station in a transition process made gradual by that truce. With the long term tide almost surely favoring the forces of reform, one should look to the vision of the reformers for hints about the future. And while their public pronouncements are of a socialist market economy, this is almost surely a sop for the conservatives, not their real goal. That goal, I would venture, is to make the genie that caused the gleaming towers to sprout in Tokyo, Hong Kong and Seoul, the power of capitalist enterprise, China's.[12]

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Of course, there may be bumps along the road to that goal. Deng Xiaoping will die, and the battle for succession may be messy. Reformers may push too quickly with lay-offs of state employees or an end to subsidies on urban housing, and in a continuing climate of urban distrust of a political elite perceived as enriching itself while ordinary people only get by, there may be another popular explosion echoing that of June, 1989. Economic growth may stall briefly in response to such events. But the long run trend seems almost certain to be one of continuing strong economic growth, continuing marketization, so that China, by the third decade of the twenty-first century, will have caught up with today's "little dragons" and, by virtue of its size, will be a mighty economic power in the world.

It is implausible to think that all one billion plus Chinese will achieve prosperity at once, however. Even in 2025, scores of millions will remain peasant farmers earning meager livelihoods from marginal land. Millions more are likely to be temporary workers and unemployed seeking work in China's cities. Having captured the magic that makes the steel towers, China will also have swallowed a large dose of the inequalities and contradictions that caused capitalist societies to breed socialist dreams in the first place. Not whether China will be capitalist or socialist, or whether China will continue on a path of growth, but rather how much of the passion for justice with which she fed and educated her still poor people in the 1970s will live on in some new form in the next century, is probably the more interesting question for those watching the Chinese saga unfold.

Notes

[1] Shahid Yusuf, "China's Macroeconomic Performance and Management During Transition," *Journal of Economic Perspectives* 8: 71-92, 1994.

[2] Figures are for 1980-91, from the World Bank *World Development Report 1993*, Table 1.

[3] *op. cit.*, 78.

[4] Chu-yuan Cheng, *China's Economic Development* (Boulder: Westview Press, 1982), 418. Industry's share of overall output, including also construction, transportation, and commerce, was about 43% during the 1970s.

[5] Nicholas Lardy, "Food Consumption in the People's Republic of China," in R. Barker, R. Sinha and B. Rose, eds., *The Chinese Agricultural Economy* (Boulder: Westview Press, 1982), 161.

[6] See especially Friedrich Hayek, "The Use of Knowledge in Society," *The American Economic Review* 35 (1945), 519-30.

[7] Janos Kornai, "The Soft Budget Constraint," *Kyklos* 39 (1986), 3-30.

[8] Gary Jefferson and Thomas Rawski, "Enterprise Reform in Chinese Industry," *Journal of Economic Perspective* 8: 47-70, 1994; 58.

[9] The word "enterprise" is used to indicate that these figures exclude purely household-level activities, such as crop production, small-scale animal husbandry and trade.

[10] Terry Sicular, "Going on the Dole: Why China's State Enterprises Choose to Lose," unpublished paper, University of Western Ontario, 1994.

[11] Examples of the strides made by the reform process, of late, include the end of food rationing in China's cities, the shift to market pricing for most products, development of the Shenzhen and Shanghai stock markets, and new official formulations such as the "socialist market economy" and the "corporatization" program in the state enterprise sector.

[12] In focusing on the contrast between the big "isms," I neglect such subtleties as the crucial role of the state in fostering capitalist development in the countries just listed, a point that looms large in the current discussion of development. It is quite natural to suppose that China's brand of capitalism will be as much state-supported as were the models of its neighbors.