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CHINA: THE TECHNOCRATS WIN

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Every great revolution goes through a phase of ideological fanaticism and wild oscillation of policies. Eventually this gives way to a more sober, calculating desire to increase standards of living and to ensure stability. The revolutionaries die off; the technocrats come to the fore. China appears to have moved decisively from the period of fanaticism and instability to a more calculating, technocratic, growth-oriented period.

In this new phase, what has been achieved so far is mostly irreversible. The advance of a market-oriented reform program at the present rate is, however, unlikely to continue at its present pace. Power struggles and sectoral setbacks of various kinds are inevitable, but steady, unrevolutionary progress is likely within the context of very conservative political and financial management.

China's recent politics has been dominated by three major factions: a radical Maoist faction dedicated to extreme egalitarianism and to extreme collectivism in industry and agriculture; a reform faction dedicated to market-oriented economic reform and initially to greater political democracy; and a Stalinist conservative faction which desires to emphasize national security and political stability.

During the last ten years of Mao Zedong's life, from 1966 to 1976, the ideological faction dominated. The Communist Party organization was decimated, as was the government bureaucracy. Military organization was severely crippled as ranks were abolished and able commanders were humiliated. The educational system was nearly destroyed when hyperegalitarianism destroyed standards and scholars were purged. Industrial and agricultural production were disrupted, and in some regions hunger became the norm. Intellectuals were systematically humiliated and removed from influential positions. Overall, the upheaval of the Cultural Revolution was greater by far than what has occurred since 1978 in Iran.

The resultant instability and poverty caused revulsion against the ideological programs among most of the major groups concerned: the Communist Party leadership, the governmental leadership, the intelligentsia, workers, farmers, and the military. Without Mao Zedong as a leader, the coalition of old guerrillas, radical youth, and Communist Party ideologues which led the Cultural Revolution was demoralized and isolated. Today, much of the public analysis of China focuses on a fear of return of the old ideologues, arguing that the experience of terrible instability in the past implies a similar possibility in the future. However, this disregards the public revulsion against the ideologues, the power of the groups opposed to them, and their own fragmentation. The terms of struggle have changed and the struggle is now between two other groups.

In 1978, China produced an ambitious Stalinist economic plan calling for rapid growth based on extremely high rates of saving and on investment in heavy industry. Hardly had that plan got underway than it became clear that China lacked the finances, the management, the infrastructure, the energy, and the experience to implement such a program. To China's credit, these problems were recognized early, and the plan was terminated.

This gave the market-oriented reformers, led by Deng Xiaoping, their chance. Deng put forward a program of political democratization and economic liberalization as the alternative. His program was helped both by the economic failure of the earlier plan and by the enthusiastic criticism of the existing leadership by those who wrote posters for Democracy Wall.

Deng Xiaoping's reforms since 1979 amount to an economic revolution. In agriculture, while the state still formally owns the land, the household has once again become the unit of production and it responds to market incentives. In industry, much planning has been decentralized, firms have been allocated a great deal of responsibility for designing their projects, deciding how to manufacture them, and deciding how much to manufacture. Workers can be paid on the basis of their production and awarded bonuses. Factories have to pay the price of their capital, and are allowed to retain some profits for use according to their own plans. Foreign investment has been liberalized. The right to import capital goods has been modestly decentralized. Agriculture and light industry have been given theoretical priority for investment over heavy industry.

Parallel to these economic reforms, Deng Xiaoping has carried out massive administrative reforms. China has a new constitution. Managers have replaced political ideologues in managing enterprises. Technical confidence has once again become respected in assigning people to government positions. Much of the old guard of revolutionary guerrillas and ideologues has been retired or relegated to advisory commissions. Deng Xiaoping, like his predecessor Zhou Enlai, is a patient builder of organizations. As Zhou Enlai understood, people who patiently build organizations will, in the end, triumph over those who go on disorganized rampages.

The economic consequences of the reform have varied enormously from sector to sector, but in aggregate have already proved spectacular. Implementation of reforms has been most far-reaching in agriculture. Taking a farmer who has been buried in a commune of 25,000 people, who has no effective control of his land or his crops, and who is paid in work points for showing up in the fields regardless of whether he does his work, and moving him to a situation where he has control of a substantial piece of land for fifteen years, control of the crop and farming procedure, and an assured share of the output, transforms him into a new man. China's agricultural progress has been steady and rapid since the reform, despite bad weather and despite many detailed difficulties (such as persuading individual farm households to maintain farm equipment properly). The enthusiasm of the farmers for these reforms is boundless. Taking away their incentives and 15-year land rights would inspire bloodily revolts.

In light industry, the impact of the reforms has been more mixed. Every factory has to overcome a tendency of the workers to resist hard work and to demand that everyone receive the same bonus. Nonetheless, a nation where only a few years ago people wore only blue work outfits and possessed virtually no consumer goods has been transformed into a nation where people wear all kinds of colorful clothing, ride bicycles, and are beginning to accumulate radios and basic household goods. Growth in consumer products has been spectacular. For instance, in 1983 production of refrigerators grew 120 percent and of

color television sets 160 percent. While implementation of the reforms in light industry has just begun, momentum will gather year by year, and soon most of these reforms will also be irreversible.

In heavy industry, implementation of the reforms has hardly begun at all. Although heavy industry is supposed to grow much more slowly than light industry, in 1983 heavy industry grew 12.4 percent and light industry 8.7 percent, due to the political clout of heavy industry and the continued attraction of large projects for China's top leaders. In heavy industry it is very difficult to identify the contribution of a specific worker, so the system of responsibility and bonuses is difficult to apply. Moreover, the bureaucracies of heavy industry are simply larger and more entrenched than those in light industry.

In the foreign economy, trade has grown remarkably. Foreign investment has been slow, due to extraordinary red tape, the fear by Chinese officials that wily capitalists will trick them, and the slow process by which China produces the detailed rules which will govern foreign investments. Progress is being made, however, and investment is accelerating. China's experience with coastal areas partially opened to foreign investment and foreign methods of production has been judged a political and economic success. As a result, fourteen cities are being opened for additional intercourse with the dangerous capitalist world. This opening, and the travel abroad of thousands of Chinese students, scholars, and officials is transforming the outlook of much of China's present and future elite. A decade ago, most Chinese officials spoke with contempt about Taiwan and South Korea; now they openly envy economic progress there and wish to emulate it.

China has also reformed its foreign policy in order to facilitate its economic development plans. It has opened friendships with Western countries in order to facilitate trade, investment, and technological transfer. It has launched a peace offensive toward Taiwan, and promised to preserve Hong Kong's capitalist system. And it has drastically reduced its tensions with the Soviet Union despite continuing disagreements over Cambodia, Afganistan, Mongolia, and Soviet troops on China's border. China's courtship of Japan has included extraordinarily friendly mutual visits by Prime Minister Nakasone and China's Party leader Hu Yao-bang; the results have been profitable, although China still nurses grudges from Japan's invasion in the 1930s and Japan still resents the mass cancellation of projects after the failure of the 1978 development plan. Similarly, mutual visits by Ronald Reagan and Hu Yao-bang have facilitated technology transfer agreements. Trade with the Soviet Union has been growing exponentially.

China's economic growth rate has been far higher than planned. This has generated shortages of energy and transportation. Investment has been far higher than anticipated. China's leaders are upset that people actually invest in many enterprises which are unsuccessful and that they show more desire to invest in high profit consumer goods than in goods which the state deems more essential. The more rapid progress of the rural reforms has increased inequality in the countryside and has led to the phenomenon of "rich" peasants visiting the towns and putting on airs before their less advantaged urban brethren. The opening up of cities along the China coast will once again worsen the old inequality between the relatively well-off coastal areas

and the relatively deprived Chinese interior. These economic and social developments have generated opposition of several kinds.

First, there has been a backlash from the old ideological factions which are presently out of power and from those who find the intrusion of foreign ideas, foreign goods, looser social controls, and free market enthusiasm disturbing.

Second, there has been resistance to reforms by those who suffer immediate disadvantages: military officers whose budgets have been cut in favor of economic development; heavy industry managers whose prospects are being subordinated to those of light industry; party leaders who have controlled everything and now are, in many cases, confined to educational tasks; security people who are concerned about the presence of so many foreigners and the mobility of so many Chinese; those workers who would rather be lazy and secure than hardworking and prosperous; managers who are threatened by the new emphasis on technical competence; and government officials who understand that market-oriented controlled industry means loss of key political levers.

Third, there are those who fear instability and loss of political control. Some fear increasing budget deficits and inflation. Some fear loss of ability to retain central political control over an increasingly market-oriented economy. Some fear the criticism of the democracy movement.

These forms of opposition have generated three great movements which affect the future prospects of the economic reforms.

First, Deng Xiaoping is undertaking a massive purge of the Communist Party in order to eliminate several million cadres who came to power during the Cultural Revolution and who might form the core of a future ideological attack on his policies. This purge appears to be going forward slowly, but it is a three-year process and its results will not be known for some time.

Second, there has been a vast campaign against spiritual pollution, defined vaguely as everything bad for the spirit, from pornography to modish dress to excessive foreign influence. This campaign limited Chinese contacts with foreigners, frightened intellectuals, and did clamp down on various kinds of liberal behavior. Many feared that it would expand into a vast xenophobic campaign in the manner of past Chinese ideological outbursts. However, it provoked massive resistance throughout China and eventually Deng Xiaoping himself squashed the campaign and its leader.

Third, there has been an organizational effort to reassert central political and economic controls. Control over investment and planning has been significantly recentralized. The democracy movement has been crushed; Deng Xiaoping viewed it with a different eye when it was a critic of his own group in power than he did when it was a critic of his opponents. The central guiding role of the Communist party has been reasserted. Party leader Hu Yaobang has emphasized that developmental efforts will continue to focus heavily on selected major projects.

The fate of the first two movements implies a continued emasculation of the ideological faction. Communist ideology is a central guiding force in

China, and will remain so for the foreseeable future, but its most fanatical egalitarian forms are rapidly dying out--as they have at the beginning of each major Chinese dynasty.

The third movement represents the central balance and central tension that will dominate Chinese society for the foreseeable future. The market economy generates economic growth and extraordinary enthusiasm. It also deprives government and Party leaders of total economic authority and thereby threatens the basis of central Communist political control. The control apparatus will react to retain its power. Market-oriented liberalization will always be constrained by the leadership's priority of retaining control. As reforms develop "excessive" momentum, there will be reaction; progress will be halted or set back. Despite this, there remains enormous room for further liberalization within the constraint of continued central political control.

For instance, one of the central problems today is the conflict between the need of the market for decontrol of prices (without which enterprise profits frequently reflect arbitrary pricing decisions rather than the real balance between supply and demand) and the determination of the political leadership to retain central control over many key pricing decisions. The Chinese leadership still has a great deal of leeway to decontrol many consumer prices and other prices of non-sensitive goods, while retaining control of the prices of key grains and industrial inputs.

In general, then, those who benefit from continued reform and growth are more numerous and stronger than those who are hurt. Further rapid growth should generate increasing resources with which Deng Xiaoping can attempt buy off the most powerful of those whose interests are temporarily damaged by his programs. (Currently Deng Xiaoping is scraping together every penny he can to mollify the military, and he is allowing the military effectively to establish its own trading firms--a la Suharto's Indonesia.) The old problems of inequality within the countryside, inequality between city and countryside, and inequality between the coast and the interior will reemerge, but these problems are omnipresent in Chinese history and appear manageable today. In the battle between market reform and central political control, central political control will always remain dominant, but there is plenty of room for mutual advancement of these two principles.

All of these developments occur within the context of China's extremely conservative style of financial management. China was badly scarred by one of the world's most terrible inflations in 1948, so China's leaders are terribly sensitive about excessive budget deficits or excessive inflation. Deng Xiaoping worries more about inflation than Paul Volcker does, and the Chinese Communist leadership would never tolerate budget deficits proportionately as large as those of any post-World War II U.S. administration.

Likewise, on the foreign account, China suffered terribly in the century preceding 1949 from the political and economic consequences of ill considered and forced foreign loans. Hence, it has sought to accumulate large reserves. It has been hesitant to borrow. It has recently run large current account surpluses. In this respect, Beijing's management principles precisely mirror those of Taipei. Because of this, the risk of financial mismanagement leading to rescheduling is miniscule. The most salient risks in doing

business with China concern not macroeconomic mismanagement, but misunderstanding as to the interpretations of contracts, Chinese inability to meet the full conditions of contracts for trade or goods, and a tendency for the Chinese to invoke various kinds of force majeure at the slightest change of the wind.

When one combines the steadily growing Chinese market, the continued rapid opening of that market, the financial conservatism of the Chinese leadership, and the traditional fascination of outsiders with the Chinese and their market, one obtains a situation in which China is approached by an excessive number of foreign companies and foreign banks. China is overbanked, both in the sense that too many banks are competing for a small market and in the sense that too many are willing to accept substantial short-run losses in the hope of obtaining a significant share of this market over the long run. This situation in turn means that China has considerable freedom of political choice among the available banks.

Thus the central problem in dealing with China is not risk but market access and profitability. Over past centuries, many firms have felt called to the China market, but very few have made substantial profits. Those who have succeeded have made the necessary investments, especially of time and energy, have focused on specific market segments, and have pursued their strategy over a long period of time with a tremendous emphasis on political access and cultural sensitivity.