Despite continuing attempts at economic reform, China remains hobbled by its political rigidity and a determination to maintain a centrally controlled structure. Paradoxically, writes Goh Keng Swee, the greatest economic successes are being recorded by small enterprises away from the centre, operating on market-economy principles.

If asked to cite the year the Chinese giant awakened, most people would choose 1979, when Deng Xiaoping started the reform of China's economy which produced such dramatic results. Annual economic growth since then has averaged 9 per cent. Today it is hardly an exaggeration to say that businesspeople in Western industrial countries are dazzled by the prospects offered by the huge and burgeoning market of 1.2 billion people.

But 1979 is the wrong answer. The giant woke up thirty years earlier. According to an IMF report of February 1981, China's national income grew between 1949 and 1952 at an average of 19.3 per cent, gross industrial output at 34.8 per cent. During the first Five-Year Plan, growth moderated somewhat; income grew at 8.9 per cent a year, industrial output at 18 per cent.

Let us find out what happened during the early years to explain this unprecedented performance. Part of the reason can be traced to the unification of this huge country by the victory of the Communist Party of China, ending a century of unending turmoil which began with the first Opium War in 1840.

Some may argue that, beginning from a low base, it is not difficult to achieve high rates of growth provided you have strong leadership. But this is only a partial explanation. Some economists hold that the poorer a country is, the more difficult it is to get rich. Economic theory states that since the poor save less than the rich, poor countries cannot accumulate enough to provide for the large investments needed to push the economy forward.

The major push to the economy in the early years came from large economic aid supplied by the former Soviet Union to start China's industrialisation program. Not only were both countries of immense size, but both ran what we now call centrally planned economic systems, or command economies.

Central planners of giant economies share another common trait. They give high priority to heavy industry. Thus the Soviet Union aid projects between 1949 and 1959 set up 156 large industrial enterprises. Of these, 21 were in iron and steel and non-ferrous metals, 27 in electric power stations and no fewer than 63 in the machine-building industries.

Sino-Soviet cooperation was effective, as the IMF statistics showed. One party had the technology and the other party supplied competent and willing learners. The relation between teacher and pupil was doubtless made comfortable because both were fervent believers in Marxist socialist ideology. However, this socialist camaraderie ran
Table 1: Average annual growth rates (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>National income</th>
<th>Gross agricultural output</th>
<th>Gross industrial output</th>
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<tbody>
<tr>
<td>1949-52</td>
<td>19.3</td>
<td>14.1</td>
<td>34.8</td>
</tr>
<tr>
<td>1953-57 (First Five-Year Plan)</td>
<td>8.9</td>
<td>4.5</td>
<td>18.0</td>
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<tr>
<td>1958-62 (Second FYP)</td>
<td>-3.1</td>
<td>-4.3</td>
<td>3.8</td>
</tr>
<tr>
<td>1963-65 (Recovery from Great Leap)</td>
<td>14.5</td>
<td>11.1</td>
<td>17.8</td>
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<tr>
<td>1966-70 (Third FYP)</td>
<td>8.4</td>
<td>3.9</td>
<td>11.7</td>
</tr>
<tr>
<td>1971-75 (Fourth FYP)</td>
<td>5.6</td>
<td>4.0</td>
<td>9.1</td>
</tr>
<tr>
<td>1976-79 (Fifth FYP)</td>
<td>6.2</td>
<td>5.4</td>
<td>9.3</td>
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into trouble in the late 1950s.

We need not concern ourselves about the rights and wrongs of the dispute between them, which became increasingly open and acrimonious. Let us look at the economic outcome. During China's second Five-Year Plan (1958-62), national income declined at an average of 3.1 per cent a year. You will recall that this was the period when Chairman Mao was dissatisfied with growth rates of 19.3 per cent and 8.9 per cent recorded previously. He launched the Great Leap Forward. It turned out to be an unmitigated disaster. More damaging than the fall of national income was the decline in agricultural output, averaging 4.3 per cent over five years. When the population had just enough to eat to begin with, a decline of this magnitude must have inflicted enormous suffering. Following the second Five-Year Plan's end in 1962, China put in two years of effort aimed at undoing the damage. The economy rebounded quickly, with national income growing at 14.5 per cent a year and farm output at 11.1 per cent. The third Five-Year Plan (1966-70) witnessed a revival of Chairman Mao's practice of permanent revolution. This time, the effort was thoroughly orchestrated and reached new heights of recklessness. I refer, of course, to the Great Proletarian Cultural Revolution. Strangely, despite the upheavals caused by the Red Guards, the economy did not suffer. National income grew at 8.4 per cent a year, agricultural output at 3.9 per cent. The reasons for this outcome are unclear.

There was enormous waste of resources when state enterprises produced not what consumers wanted but what central planners decided.

Perhaps the Red Guards vented their rage on persons and cultural objects such as ancient temples. Or perhaps those in charge had learnt from previous experience how to work out methods of damage limitation. During the two following Five-Year Plans, between 1971 and 1979, growth moderated to just under 6 per cent, agriculture at 5.5 per cent, industry at 9.2 per cent. These growth rates would be judged satisfactory in developing countries and in fact exceeded the target set by the UN development experts: 5 per cent annual growth. But these figures concealed major flaws which the leaders under Deng Xiaoping saw through. There was enormous waste of resources when state enterprises produced not what consumers wanted but what central planners decided. The lack of competition encouraged inefficient production.

Let me return to the subject of the build-up of technology which the Soviet Union introduced to China during 1949-59. This great effort set China briskly on the path of industrialisation. When it ended in 1962, China was able to make further advances on her own. To assess her progress in this field we must examine the expansion of the education system.

The number of tertiary education institutions more than trebled in 30 years and the increase in secondary schools was almost as big. The number of graduate students enrolled in universities increased from a bare 629 in 1949 to 21,604 in 1980. By 1992 it had grown to 94,164. The distribution of students among faculties is as
The concentration on the natural sciences and their applications in engineering, agriculture, medicine etc. accounts for some 62 per cent of the total and is doubtless the result of the state policy of increasing the country’s productive capacity. Large though the numbers look, they are small in relation to the needs of a large country like China. In the 1980s the number of graduates equalled those who graduated in the preceding three decades. Even so, there is considerable scope for expansion; at present tertiary education comes to no more than 2 per cent of the age group cohort.

Even before Deng Xiaoping’s reforms got going, therefore, China had achieved significant economic progress through Russian assistance in the first decade and by her own efforts thereafter in producing trained manpower. But the economy suffered from the usual weaknesses which all centrally planned systems experience. Factories were set up by the state and produced goods determined by the Central Planning Commission. Workers were assigned by the Labour Ministry. They were not free to choose occupations and once assigned to the employing unit, they enjoyed permanent employment. Capital was supplied by state banks according to the central plan. Wages and salaries, prices of goods and interest rates on loans bore no relation to the realities of supply and demand.

The drawbacks of the command economy are well known. But one element needs to be emphasised: the ideology that dominated thinking on important policy issues. To name some items in the ideological menu:

- the working class (or proletariat) forms the most advanced section of society;
- a socialist society is superior to a capitalist state;
- the means of production must be owned by the state.

A socialist society is run on a political system embodying what is termed “democratic centralism”, meaning that the Communist Party holds supreme power, and within the party, authority is vested in the Politburo, a handful of leaders. That was the way the revolution was won and that was the way China was governed between 1949 and 1979. Even today one can say that the political system remained essentially the same, despite no fewer than four revisions of the constitution.

The third plenary session of the Eleventh Central Committee held in December 1978 was a landmark event. Under Deng Xiaoping’s leadership, China took the first steps towards loosening rigid central controls over production. The first efforts were directed at agricultural production and peasant families were allowed some choice of what to produce once their quota obligations were met. The system, called a contract responsibility system, was later extended to state industrial enterprises.

At the same time, provincial governments were given more authority and this delegation down to the lowest tier of government – the township government – had the intended effect of promoting local initiative. Central planning controls over the allocation of supplies were gradually relaxed. Output above the quotas set in state plans could be sold at higher prices. A two-tier pricing system emerged.

The relaxation of controls over prices and production occurred gradually, and not in the so-called “big bang” fashion adopted in Russia after the break-up of the Soviet Union. Even as late as 1992, 30 per cent of consumer goods (in terms of value of sales) and 42 per cent of industrial raw materials remained under state control.

The result of Deng’s economic reforms has been a growth of the economy in the past 15 years that must be considered spectacular by any standard. Whereas the former mentor, the Soviet Union, has broken down in an unexpected and dramatic way, China continues to register success after success. But it would be unwise to project the future as a continuation of the past, because some deep-seated troubles continue to beset the economy.

These troubles have their origin in the attempts to graft a market economy on to a political system designed for a different purpose – to manage a command economy. Their compatibility between the requirements of a market economy and the political structure has produced setbacks which have yet to be overcome.

First is the boom-bust cycle. Marxist dogma asserts that the business cycle is an inherent feature of the capitalist world. But where industrial countries have learnt to moderate the business cycle through fiscal and monetary policies, the Chinese have been groping for a solution, so far without much success.

The second problem is even more serious. This concerns the poor performance of state-owned

<table>
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<th>Table 2: University graduates 1949-79</th>
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<tbody>
<tr>
<td>Engineering</td>
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<tr>
<td>Natural Sciences</td>
</tr>
<tr>
<td>Agriculture, Medicine etc</td>
</tr>
<tr>
<td>Teacher Training</td>
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<tr>
<td>Other (Humanities, Economics etc)</td>
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<tr>
<td>TOTAL</td>
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Wages and salaries, prices of goods and interest rates on loans bore no relation to the realities of supply and demand.
enterprises. Nearly half of them are losing large sums of money and have to be kept alive by subsidies from the state budget.

Every year Premier Li Peng draws attention to this problem in his address to the National People's Congress. Many remedies have been tried over the past eight years but to no avail. In a market economy, enterprises which lose money year after year will close down. This option is not open to Beijing because it could mean laying off some 20 million workers – and the leaders believe the ensuing turmoil would cause an unacceptable level of political instability.

The third unresolved problem could perhaps produce the most dangerous long-term result. This is the widespread corruption among those in positions of authority. Given the low salaries of officials, those with authority to grant licences, allocate supplies or set interest rates on loans would have to be saints to resist temptation. The redeeming feature is that leaders at the pinnacle of power remain untainted.

The last of the big unsolved problems concerns the progressive weakening of the central government in its dealings with provincial and local governments in industrial, financial and economic matters. The coastal provinces which have benefited most from the reforms have become increasingly independent of the centre for funds. In fact, the centre relies on these provinces to collect revenue on its behalf. Strange though it seems, China practises a kind of tax-farming system used in the later years of the Qing Dynasty. One of vice-premier Zhu Rongji's reforms aims to straighten this matter out by setting up a national revenue-collection system under Beijing's direct control.

At first sight, the weakening of the centre must appear an improbable outcome. Supreme power rests with the party's Central Committee. How could provincial party secretaries and governors disobey the Politburo?

Matters can be complicated when governing a large country through a system of government with multiple layers – centre, provincial, municipal or prefecture, county and township. In all, there are more than 50,000 governments in China. But China's difficulties spring from more than simply size. The US is a large country with the world's largest economy. But the Americans do not experience trouble with centre-local relations. Nor did the former Soviet Union, so long as it stuck to the command economy for which the political institutions were designed.

In effect, what has happened over the years is that China has become a federal state as provinces acquire increasing authority and wealth – but it is a federal state without a federal constitution. As a result, centre and provinces engage in continuous negotiations over issues such as the sharing of taxes, control over enterprises, access to bank credit, foreign exchange, imports and exports of goods and a hundred-and-one other items.

A federal constitution would have defined the limits of authority of provincial governments and enabled disputes to be referred to a Supreme Court. The absence of such a system has given rise to a paradox: China has a strong one-party regime but its capacity to formulate and implement economic policy is feeble.

Much of China's current difficulty can be traced to the failure of political reforms to keep pace with economic reforms. This may seem a novel and contentious conclusion but it is not so. As early as 1986, Deng had been pressing for political reforms, a subject seldom discussed in China today.

On 3 September 1986, Deng said: "... our political structure does not meet the needs of economic reform ... Whenever we move a step forward in economic reform we are made keenly aware of the need to change the political structure. If we fail to do that, it will stunt the growth of the productive forces and impede our drive for modernisation." Then, in an independent discovery of Parkinson's Law, he said: "At present, leading organs at various levels have so many people on the staff that work has to be found to keep them busy."

Deng had three objectives in mind. The first was to revitalise the party by enlisting younger, better-educated and more professionally competent cadres. Next, to reduce overstaffing to increase efficiency. Third, to stimulate initiative at the grassroots by delegation of authority.

Among the shortcomings, he highlighted the need to stop party cadres from interfering in affairs which lie within the responsibility of the governments. The separation of party and government stood high on his agenda. He also drew attention to the need for a modern legal system, the existing one being flawed especially by the failure of enforcement measures.

Action soon followed. The Office of Reform of the Political System was set up in September under the direct charge of Prime Minister Zhao Ziyang. In December, seven special study groups were formed and by mid-1987 they had produced a report titled General Concept of Political Reform. The document went to the upper reaches of the party leadership and was adopted by the Thirteenth Party Congress in October 1987.

It was a genuine effort by the top leadership to reform the political system. But although some of the reform measures were initiated in 1988 and 1989, in the end the entire program was abandoned. News of the study groups' deliberations had reached staff and students at universities and provoked much excitement.

Unfortunately, the years 1988-89 saw the peak of China's business cycle, with associated high rates of price inflation, exceeding 25 per cent in major cities. University students living on fixed and small stipends were badly affected. Their feelings were aggravated by the knowledge that people in positions of authority in government and business were spending money freely – money which clearly did not come from their meagre salaries. Discontent became widespread. The final result was the Tiananmen tragedy in June 1989.

This account of major events in post-reform China has been largely a story of unsolved problems ending in a
Table 3: Growth of township and village enterprises

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<tbody>
<tr>
<td>Number of TVEs (million)</td>
<td>1.52</td>
<td>6.07</td>
<td>20.92</td>
<td>13.9 times</td>
</tr>
<tr>
<td>Workers (million)</td>
<td>28.3</td>
<td>52.1</td>
<td>106.2</td>
<td>3.8 times</td>
</tr>
<tr>
<td>Output value (billion yuan)</td>
<td>49.5</td>
<td>169.8</td>
<td>17,659.7</td>
<td>35.7 times</td>
</tr>
<tr>
<td>Output per worker (yuan)</td>
<td>1,752</td>
<td>3,259</td>
<td>16,563</td>
<td>9.5 times</td>
</tr>
</tbody>
</table>

political tragedy. How, then, was the country able to achieve so high a level of economic growth? Why do foreign businessmen get excited? We can say that in the first half of this period, say up to about 1985, the relaxation of controls did produce economic expansion in most sectors of the economy, including state enterprises. These became a burden in the second half of the decade. But something unexpected occurred, unexpected even by Deng himself, which more than made up for the shortcomings of the state enterprises. This was the extraordinary growth of industry in the countryside.

Township and village enterprises (TVEs) are businesses launched usually by township governments and sometimes by village leaders or even individual farmers. They are called "rural collective enterprises" to distinguish them from state enterprises and urban collectives.

What caused the unprecedented expansion of a type of enterprise that is unique to China? How could rural folk seize business opportunities on such an extensive scale? How did they get market information and acquire manufacturing know-how? Why did expansion take place in the countryside and not in the cities?

There are conditions, some of which exist only in China, which explain the phenomenon. One of these is control over population movement by a system of nationwide household registration. This acts to prevent the flood of rural migration to the cities which happens in most Third World countries. Without special permission to move, people remain where they live.

The second condition is the extensive build-up of manufacturing know-how arising from the concentration of studies in engineering and applied sciences. Most of the engineers work in the cities, mainly in state enterprises. A third factor is the sustained effort to enlarge the scope of the machine-building industries. Even though much of the output does not reach international standards, the prices are low and the machines can be bought without foreign exchange.

Fourth, shortages of consumer goods were a marked feature of the economy and remain so today. This presented a wide choice of products for promoters of TVEs. Finally, surplus labour was a troublesome problem in rural areas, concentrating the minds of township authorities on ways to create employment. At first, TVEs concentrated on simple production such as building materials, food processing or transport services. After 1984, they began more complex production, obtaining technology, machinery and engineering expertise from nearby cities. In one important respect, their management and operational methods were the opposite of those used in state enterprises. They had to compete for supplies and materials as well as in the sales of their output. If they lost money they would eventually close down and the workers would go back to the farms. In other words, they operated under the hard budget constraints of a competitive market. By 1992, the output value of TVEs equalled that of state enterprises. It has since passed them.

China's economic growth could not have been possible without the great effort to accumulate knowledge in science and engineering since 1949. When this knowledge was applied in a command economy, the results were unsatisfactory. Gradual reform at first produced expansion of output but later brought great strains on the system because of the rigidities of the political system. The outcome was a number of unsolved problems which will have to be addressed, perhaps with a greater chance of success, in the post-Deng era. It is in the rural economy, operating outside major political controls, that rural enterprises were established under a competitive market. These have achieved rapid and sustained growth.