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Will China Liberalize?

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As the world enters the post-Deng era, speculation has become rife over China's future direction. Even before Deng's passing, governments, companies and academics world-wide had for several years engaged in building scenarios of China's future, many focusing on 2010 as some set time by which China's future would somehow be concretized. The world was awakening to the fact that despite all the negative press related to Tiananmen, the economy of the largest country in the world had been growing at an average annual rate of approximately 10 percent for 20 years. In 1997, China would absorb Hong Kong, the world's 8th largest trading territory, and with it immediately increase its GNP by 15 percent. What if these growth rates continue? Would it affect China's polity? Suddenly, what kind of system emerged in China had enormous implications for the future of the entire world.

Studies focused on whether China would become a democracy or remain an authoritarian regime along current lines or somehow become an East Asian "soft authoritarian regime" like Singapore. Would the Communist Party continue to rule or would China follow the Burmese or Indonesian model and have the People's Liberation Army take control? Would it survive as a unitary nation-state or splinter into numerous smaller political units much like Europe after the fall of the Holy Roman Empire?

The focus here is "liberalization:" economic, political, and transnational. In each case we know what a liberalized system would look like.
Economically, it would be one dominated by market forces, with limited administrative regulations which empower bureaucrats. In terms of China's global ties, a liberalized system would allow relatively free trade, free activity by foreign investors, and free flow of goods, services and people across its boundaries. Finally, political liberalization implies some form of free electoral system, with active participation by social interests through formal groups or political parties, as well as by unions not controlled by government cadres.

As Peter Schwartz argues, good scenarios need good "drivers," underlying social, economic, political, or technological forces that push those scenarios in particular directions, whose rise or fall play a critical role in redirecting future events.¹ For me, key drivers affecting China's future are its property rights system, the growth and expansion of market forces, and the role of bureaucratic authority. Let me state here, however, that the exercise that I am engaged in is not quite scenario building. I am not projecting several potential outcomes for China based on the intersection of underlying trends. Instead, I am raising the question: how far liberalization? How powerful are the underlying forces pushing for the liberalization of China's domestic market, its global linkages, and its domestic polity? What are the constraints against
continued liberalization? Can China's domestic economy continue to grow without the emergence of a liberalized political regime?

Three Questions and Some Brief Answers

1. *Will China make the domestic transition to a free-market economy? How much change can one expect in the next 10 to 15 years?*

Market forces will continue to expand, and in fact, have already gone quite far, as most firms in China produce for the market, not in response to a planned allocative system. Moreover, successful firms want to sell nationwide in order to increase their economies of scale. But counter pressures that slow continued liberalization of the domestic economy include the central government's desire to contain energy costs, the power of local governments to influence the economic decisions of factory managers, tax incentives for regional and local protectionism, a desire by economic actors, and particularly bureaucrats, to earn the economic *rents* that exist in a semi-market--semi-planned economy, and a preference for *relational contracting*, where people rely more on personal ties than free market prices when choosing suppliers and customers. Legal difficulties in winning a case in another enterprise's jurisdiction limit transregional exchanges. Also, domestic politics may limit
market liberalization because of the government's need to protect its antediluvian state-owned enterprises (SOEs) and the jobs of its massive underemployed work force.

2. Will China continue to open to the outside world economically?

Strong bureaucratic incentives work against liberalization, including China's current interest in establishing an industrial policy as a means by which to develop "sunrise" industries. As China looks outward it sees that neomercantilism, whereby the state, according to Peter Evans, "created comparative advantage" in industries formerly dominated by Western states, was the way poor countries escaped from the economic periphery. Despite all the rhetoric about China's opening, since 1978, China has established and maintained a "transnational sector" along its border with the outside world, through which it has cordoned off important sectors of the domestic economy from external competition.³

No doubt, international market forces create powerful incentives for domestic actors with comparative advantage in cheap labor and competitive products to advocate global linkages; but their demand is for export privileges, not an open import regime. Nevertheless, firms that gain access to foreign
technologies create comparative advantages in the domestic economy. Their products become far more competitive than those produced domestically, allowing them to earn "extra-normal profits" until new competitors enter the domestic market. So they push for strategic alliances with foreign partners, all the while opposing import liberalization which would undermine their new domestic monopolies. Finally, pressures from the World Trade Organization (WTO) and the United States Trade Representative (USTR), which hammer out agreements over market access and trade liberalization will further open China’s trade regime; but do not be surprised if change does not come as fast as some might expect.

3. *Will economic development lead to political liberalization?*

Not necessarily. If one looks at the history of democracy in other parts of the world, we find that democratization depends on the emergence of private property in the hands of a middle class that seeks protection from state interference and that challenges the state for public space. Global waves of democracy can impinge upon the actions of authoritarian leaders and invigorate political activists to confront apparently powerful regimes. However, the dominance in China of public property in the form of public companies, SOEs,
and collective enterprises owned and operated by local governments suggests the emergence of a "middle strata" of managers that allies itself with the state but does not challenge it for political power.

**Bureaucrats, Rents and Counter Trends**

In the three cases below, markets and politics press for liberalization. But in each case strong bureaucratic interests suggest a counter-trend and an alternative route and outcome.

The counter trends are based upon the bureaucrat's rational calculation and preference for a *mixed* economy, where regulations constrain private market activity and undermine what many might see as the inevitable shift to a full market economy. China is what political economists would call a *rent seeking society.* "Rents," defined as the difference between free-market prices and higher prices that exist because regulations limit the number of competitors entering the market, afford those who have arranged market entry a monopoly within that sector and prices that are higher than what they would be in a truly competitive market. Back in 1987, Chen Junsheng, the Secretary General of the State Council, recognized this problem, arguing in the *People's Daily* that China suffers from a mentality of "monopolized operation," where Chinese
bureaucrats insist that all other units producing similar goods be closed and competition not be tolerated. This desire for monopoly and monopoly rents persists in China today.

Rents are also a form of corruption, where bureaucrats charge fees for services that expand government revenues and fees for ignoring the very regulations the bureaucrats create and impose. For example, if there are both planned and market prices for certain commodities, firms and bureaucrats who get access to goods at cheap planned prices can earn rents by selling them dearly on the market. These opportunities give bureaucrats in those sectors strong incentives to maintain China’s dual price system and planned prices in their sectors. Or bureaucrats may impose special fees on firms for the permission to carry out normal market activity.

According to Wu Jinglian, a leading Chinese economist, rents created by the difference between free market and planned commodity prices, between the official value of foreign exchange and its free market value, and low credit interest rates and the real value of money accounted for 20-25 percent of GNP in 1981-1989. The value of these rents was even greater than in India or Turkey in the 1960s which according to Anne Krueger, a pioneer in the study of rents in the foreign trade sector, was under 20 percent. Little wonder, argued
Figure 1: Changes in the Decision Making Authority in the Chinese Economy

Level of Marketization

Locus of Economic Decision Making

- Quadrant A: Strong Monetary and Fiscal Policy
- Quadrant B: Traditional Central Planning System
- Quadrant C: Local Corporatism or Relational Contracting
- Quadrant D: Free Market Capitalism

Real direction of change
Assumed direction of change

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Wu, that government related businessmen in China who earn rents, "try by every means to maintain the existing rent system and establish a new rent system to expand the scope of rents." These interests will resist economic liberalization.

With bureaucratic interest as a driver, let us look at our three sectors in greater detail.

1. **Will China make the domestic transition to a liberal, free-market economy?**

   Figure 1, "Changes in the Decision Making Authority in the Chinese Economy," visualizes the argument applied to the domestic economy. While many assume that decentralization of economic decisions from the center to the local level (movement from left to right on the horizontal access) along with a significant shift in the number of goods from the central plan onto the free market (movement from top to bottom on the vertical axis) would lead to greater decision making freedom by individuals and firms, expanded market
activity, and a transition to free market capitalism. That is, a shift from Quadrant B to D.

Instead, strong domestic forces opposing economic liberalization have pushed China into Quadrant C, where local governments still make important economic decisions about the allocation of goods and services and impede the free flow of goods and services across regions. Firms themselves behave in ways that undermine the transition to a free market economy.

A. Forces Resisting the Transition to Capitalism

a. Local protectionism:

In the mid-1980s, China reformed its fiscal system, creating a tax farming system under which all levels of government were given tax quotas to pass up to the next level of government. Some or all enterprise the profits and taxes above the quota could be retained by the local government. At the same time, many local and regional governments lost their tax subsidies as the state now lacked the funds to bankroll them; suddenly they had to swim or sink. These conditions gave local governments powerful positive and negative
incentives to maximize local output, sales, profits, and taxes leading territorial governments to establish barriers to transregional trade as a way to keep products from other regions out. For example, according to a recent report in the *Asian Wall Street Journal*, taxi companies in Shanghai can buy only Santana vehicles produced by the city's joint venture with Volkswagen. The fear of riotous unemployed workers also lead cities to protect moribund state-owned enterprises from regional competitors who could force their insolvent enterprises into bankruptcy.

b. *Relational Contracting*:

Shortages of quality goods, weak market signals and information, and widespread corruption create great uncertainty for enterprises under China's emerging market economy. With little sanctity of contracts and a legal system whose judges favor local firms, making it difficult for firms to win cases outside one's own region, people lack confidence about interregional trade. Under such conditions, where money alone cannot insure supply, Chinese firms resort to what Williamson calls relational contracting, a characteristic of early capitalism (as well as socialist transitional economies) where firms carry out
business transactions based on long-term, personalized trading relations and trust, not on maximizing profits and market efficiency. As Solinger has shown for China, the result is a less than perfect market, significant waste, limited inter-regional competition, and high transaction costs, as firms invest too much time and money maximizing relationships as the major mechanism for making profits.

c. Rent Seeking:

Under China's mixed economy, bureaucrats have little reason to decrease the real level of administrative regulations. Regulations, create rents that bureaucrats can reap and barriers to entry that people must pay to cross. Chinese firms, awash in a sea of rent seeking, accept payoffs as part of doing business, reinforcing a commercial culture that demands special fees for evading regulations.

Moreover, the number of Chinese companies belies the close business relations that exist between them and the government. Many companies were established under "downsizing with Chinese characteristics," where governments lay off bureaucrats from their official payrolls, only to help these people establish new semi-public firms. Situated between the government and
the enterprises, these firms earn income by charging a handling fee for
transferring these goods and resources. Like carbuncles on ships, these trading
companies draw their sustenance from their relationships with the ministries
from which they were spun off.

One of Li Peng's first responses to cries of corruption raised during the
Tiananmen protests was to close hundreds of thousands of briefcase companies
(pibao gongsi) created by retired bureaucrats in the mid-1980s. But the
company fever that followed Deng's 1992 trip to Shenzhen and the economic
liberalization it triggered has led to a massive reemergence of such companies.
Moreover, government bureaus themselves now freely pursue business
opportunities to supplement deficient payrolls.

d. Protecting State Owned Enterprises and Financial Reform:

Politically and economically, the key riddle for the current leadership is
how to stem the enormous haemorrhaging of capital that flows into (and then
out of) the state enterprise sector. With over one-third of State-owned
enterprises in the red, with SOEs employing over 160 million workers and
supporting as many as 200 million workers and dependents, China is facing a
welfare problem of catastrophic proportions. Paying the low "basic salaries" of urban workers (their salaries without subsidies and bonuses) in unproductive firms works much like unemployment insurance schemes in the West. These basic wages are usually about 40 percent of current wages and exclude all subsidies and bonuses that became necessary supplements to otherwise subsistence level incomes. Wisely, the state has moved slowly on putting these workers out on the street; otherwise as Anita Chan and Robert Senser argue, widespread riots could threaten the regime's control. Yet despite many calls for freeing the managers and letting them and their market calculations determine economic activity, party committees are again reasserting their power. Recent reports have admonished managers to rely on the party committees when making decisions about layoffs, prices, and production. Over most of the last decade, these managers have rarely threatened party control.

The troika of Jiang Zemin, Li Peng, and Zhu Rongji, the three leaders most responsible for SOEs, have consistently rejected privatization as the solution. Their most radical strategy involves selling shares to workers or perhaps other companies, but this method will not generate a private ownership class. Instead, the purchase of SOEs by foreign corporations or capital is a more likely liberalizing scenario, triggering some degree of privatization.
China's economic problems are highly interconnected. How China deals with SOEs directly affects liberalization in financial services, as bailing out SOEs undermines reforms of the banking system, which itself needs to move into a more market oriented environment. For too long Chinese banks loaned money according to national or local policy, not its real cost. Today, the state persists in pushing its policy banks to throw their monies at insolvent SOEs. With so much good money chasing bad it is little wonder the state cannot force banks in China to function on money making principles. This closes a vicious circle, where China's hunger for political stability impedes the further liberalization of its financial system.

e. Can domestic politics hold back market liberalization?

Finally, there is a close link in China between politics at the center and market liberalization. Unlike the early and mid-Deng era, when market reformers, such as Zhao Ziyang, experimented with innovative policies, current leaders appears more centrist on economic reform. In fact, Deng and Zhao pushed every major reform wave from decollectivization in 1978-80, China's external opening in both 1979 and 1984, the trade decentralization of 1987-88,
and the reform drive of 1992-94. Without Deng, whose vigour regularly triggered these paroxysms of reform, few central forces appear able to propel the system into a renewed rapid cycle of change. Entrenched bureaucratic interests, in the absence of a strong leader, will prefer gradual reform, leaving China on a constant road to liberalization, caught somewhere between the market and the local plan.

The politics of interregional disparities will also limit economic reform. Under Deng, China deregulated the economies in the coastal areas, and granted them preferential policies that helped their economies boom. At the same time inland areas were constrained from participating in global markets, even as the state suppressed the prices of the natural resources that are the heart of their economies. Small wonder the coast flourished while inland areas languished under what Solinger so aptly calls their "comparative disadvantage." And while inland areas might prefer an end to all policy favouritism and an even playing field, under the current regime they support a central government whose economic authority orchestrates significant regional redistribution. Such views are music to the ears of central planners in Beijing who also believe that the state must play the major role in resolving interregional inequalities and in guiding the national economy.
B. Forces for Continued Market Liberalization

Yet, powerful economic forces are pushing for a continued transition to capitalism which might push China into the lower right quadrant.

Enterprise managers recognize the benefits of greater efficiency, economies of scale and lower transaction costs. Those with comparative advantage in particular products favor dismantling regional barriers so they can ship their products into these new local markets and reap large profits. Top leaders may understand that the rent-seeking and corruption, which threatens regime stability are the product of a mixed economy. But applying a palliative to the wounds in the economy--such as the anti-corruption "strike hard campaign" of the past year--rather than performing the deep structural surgery needed to expunge this disease may be all this regime can muster. When corruption reared its ugly heat in 1986, Hu Qili, then a rising star of the reform faction, advocated greater liberalization, not economic constraints, as the long-term solution. While reform economists, such as Li Yining, still echo such strategies, few top leaders today express such sentiments.

Those who believe that market forces are already beyond state control take heart in the fact that growth rates predicted for the 8th Five Year Plan were
Figure 2: Patterns of International Linkages

Level of Regulation

Quadrant B
Autarky

Level of Transnational Flows

Quadrant A
Quadrant C
Mercantilist / Developmentalist

Isolated
Liberal-market / Interdependent

Quadrant D

Real direction of change
Assumed direction of change

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fulfilled in just three years. Perhaps China's economy has indeed moved into the lower right quadrant. But rapid growth alone does not make a liberalized economy; how exchanges occur, the scope of bureaucratic interference, the scale of transaction costs, and the ability of local state agencies to intervene in economic decisions, are all important indicators of where China's economy really rests and suggest the enormous interests that favour keeping China's economy in the upper right quadrant.

2. Will China continue to liberalize its economic ties with the outside world?

Figure 2, "Patterns of International Linkages," presents a visual image of the argument in this section. Here again the conventional wisdom is that increased global transactions liberalize China's trade regime, forcing it from Quadrant B, autarky, where it ended the Mao era, into Quadrant D, global interdependence. No doubt, China's foreign trade, which has grown from approximately US$30 billion in the late 1970s to over US$290 billion in 1996, at an average annual growth rate of 16-17 percent, has surpassed all
expectations. Few predicted such a large country could become so trade
dependent, with some estimates suggesting that over 40 percent of GNP is now
involved in international trade. To this extent, China has swiftly moved very
far along the horizontal axis.

But how far will it move on the vertical axis? Powerful forces within
China, among its central leaders, bureaucrats, industrial managers, and regional
officials will fight to keep it in the upper right quadrant. There China's trade
will grow but in directions set by official definitions of China's interests, rather
than be propelled along (and perhaps buffeted) by domestic or global market
forces.

a. Pressures Opposing Liberalization:

China is a mercantilist state, and its leaders have a strong preference for
remaining in the upper right quadrant. While Zhao Ziyang, and even Deng
Xiaoping, accepted the inherent benefits of interdependence, or saw its costs as
far lower than its benefits for China's modernization, China's current leaders
possess a more mixed perspective. No doubt, as David Bachman described, the
Politburo established at the 14th Party Congress in 1992 appeared to be quite
international, with the foreign minister, the then trade minister, and leaders from most key coastal cities and provinces, all part of the ruling elite. Global pressures, such as membership in APEC, as well as the demands of WTO ascension and USTR bilateral negotiations all push China to lower tariff rates. Yet, foreign investors seem undaunted by continued barriers to market access. Bureaucrats' self interest benefits from regulated trade. Finally, China's search for an industrial policy undermines liberalization. Let us look at this case in more detail.

a. Continued administrative controls over the opening:

China never wanted an open trade regime. Since 1978, it has erected a transnational sector--Special Economic Zones, Export Processing Zones, joint ventures, swap markets for foreign currency conversion--to cordon off the domestic economy from external influences. These special deregulated spaces and organizations are exempt from rules governing non-open territories, creating a dual economic system. According to Chinese economist Hu Angang,\textsuperscript{12} despite the inequalities generated by this system, and the monopolies "which undermine competition," the establishment of special zones with what
the Chinese call "preferential" (you hui) trade, tax, and investment policies create "all sorts of special and independent economic and political interest cliques within the state apparatus," who "although they are communists, regard it as their goals to maximize the interests of their own cliques, and to seek monopolies and privileges through their economic and political pursuits." For Hu, "the most difficult point of China's reform is how to deal with such increasingly growing privileged cliques."

As China opens, ministries are empowered to establish monitoring agencies which control threats to their own industries posed by trade liberalization and global competition. The Ministry of Machine Building established an Equipment Approval Division to monitor and approve all imports of equipment, including equipment for joint ventures. In 1995, as China opened the construction industry to foreign direct investment (FDI), strict guidelines were introduced and new foreign funded enterprises needed approval from the Ministry of Foreign Trade and Economic Cooperation as well as the Ministry of Construction which owns and operates their major competitors. According to the United States Trade Representative's 1994 Foreign Trade Barriers, "specific bureaus or ministries administer barriers for imports that fall under their jurisdiction." One of the strongest advocates of
continued protection is the highly vulnerable pharmaceutical industry whose State Pharmaceutical Administration "issues quality certificates for pharmaceutical products."

Legal scholars endorse the assertion that China's foreign trade regime remains highly regulated and that controlling foreign investment remains a high priority of China's trade policy. According to Pittman Potter, "state control over foreign business has remained a singular norm of the regulatory regime. The continued expansion of the Chinese legal system regarding foreign investment has been meant to strengthen the state's managerial role."13 Similarly, Donald Clarke argues that informal rules controlling administrative procedures are a greater source of regulatory constraints and are deeply inculcated into China's bureaucracy.14 According to Clarke, foreign trade "is governed by rules formulated by various concerned bureaucracies, and the rules are implemented through the everyday acts of these bureaucracies." These views were articulated by Yu Boge, General Manager of China Resources Textiles, who in 1989, following the decentralization of foreign trade in 1987-88, argued that "the existence of various export channels will only result in disrupting the market order and eventually cause losses to the state. . . . under
socialist public ownership, it is not proper to introduce free competition in foreign trade."\textsuperscript{15}

b. \textit{China's search for an industrial policy}

Recently China has become enamoured with the idea of establishing industrial policy for several key sectors. And why not? China need only look at Korea and Taiwan, where state intervention in economic development was critical and say, why not us? In these countries the state created comparative advantage where it had not existed before. American efforts to deny China its right to an industrial policy confront nationalistic concerns that the West, especially the United States, is trying to hold back China's search for great power status. An industrial policy will protect \textit{sunrise} industries, which bureaucrats see as the source of future trade competitiveness, as well as \textit{sunset} industries, which would go belly up quickly in the face of global competition. For example, insurers and banks would get swamped should China open up to global competition. Protection, however, leaves them with little incentive to reform.
c. Rent seeking in the international sector:

Finally, the foreign trade sector remains rife with rents and opportunities for corruption. While the World Bank reported that China's nominal tariff rate in 1995 averaged 32 percent, the effective rate that was collected was only 6 percent. While half of that seepage was due to special policy privileges given to foreign invested enterprises, the other half was the result of bureaucrats who waived regulations in return for payoffs. Today, in Hong Kong, for infrastructure projects, large foreign companies must give large equity shares to mainland brokers who provide no value-added except to certify that the project can go forward. One American firm working in east China froze its power project because it refused to donate an equity share to a company run by a top leader's son. While Americans by law must resist such pressures, companies from many countries rely on Japanese brokerage houses who remain past masters at the art of influence peddling. Why should these Chinese intermediaries prefer a transparent trade system? As Shirk argued, China has carried out the easy part of trade liberalization; what the World Bank calls deepening has run into problems.\textsuperscript{16} Even today, local foreign trading companies (FTCs) and the old trading companies still influence many of China's imports
and exports. No wonder Pearson found that the liberalization of China's foreign trade regime plateaued in the early 1990s.\textsuperscript{17}

d. \textit{Pressures for transnational liberalization:}

But many domestic and external forces propel economic internationalization. China's enormous comparative advantage in foreign trade creates thousands of labor intensive, export oriented firms in the countryside who want to expand export opportunities. SOEs want to fire redundant workers and import resources duty free; rural enterprises want to circumvent FTCs and deal directly with foreign markets. The result is a "\textit{joint venture fever}" which offers solutions to these and other institutional constraints. Thus today over 40 percent of China's exports are shipped by joint ventures. In protected sectors, where high tariffs prevent import of competitively priced goods, joint ventures help Chinese partners create products that are highly competitive within the domestic market. Even if their prices are a little high and their quality a little low, protectionism insures Chinese and their joint venture allies large profits. Yet letting foreign partners into the domestic market undermines government efforts to protect uncompetitive SOEs.
Foreign pressures push down the barriers of China's foreign trade regime. Since the early 1990s, the United States has consistently squeezed concessions out of China for market access and IPR. It is using China's interest in joining the WTO to weaken China's tariff regime further. China will also be able to expand its textile quotas over that imposed by the Multi-Fibre Agreement if it can enter the WTO. Participation in other global groupings, such as APEC, brings China more in line with global norms, as that group's goal of decreasing barriers to trade forced President Jiang Zemin during a senior APEC summit in 1995 to promise that China would lower it tariffs to 15 percent. Time will tell if bureaucrats actually implement the declaratory policy of the communist party's leading official.

Finally, China's bureaucrats know where their bread is buttered. They know that excessive restrictions and fewer foreign transaction mean fewer rents, giving bureaucrats reasons to promote trade and investment, albeit under their administrative purview. For them the choice is clear: no flow, no dough! The result however, is de facto, not de jure, trade liberalization--leaving China in the upper right, not lower right quadrant--as much trade ensues through smuggling and corruption. According to the World Bank, smuggled goods from Hong Kong to China equal 15 percent of all legal trade between the two
Figure 3: Relationship Between Economic Growth and Political Liberalization

Level of Political Liberalization

Level of Economic Development

LOW

Quadrant B
Totalitarianism / Maoism

Quadrant C
Corporatist Authoritarianism

LOW

Indian-Style Democracy

Western-Style Pluralist Democracy

Quadrant A

Quadrant D

HIGH

Real direction of change

Assumed direction of change

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economies. According to a recent *South China Morning Post*, the scale of smuggling was so great that it forced China's television manufacturers to cut domestic prices by 10 percent.

But China's desire to enter the WTO, and the high hurdle imposed by the United States, pushes China into the lower right quadrant.

3. Economic Development and Political Liberalization

Finally, will economic development and market liberalization bring the political liberalization many pundits and politicians predict? Many point to South Korea and Taiwan, where economic growth created social demand for political change. But while increased trade increases information about the outside world, those who see a direct relationship between economic development and political freedom ignore a key theoretical point. What made Britain democratic was not just economic growth but the emergence of a middle class of private property owners with an economic interest to get the state of its back.¹⁸ But is China's property rights regime and the fervour of economic development creating such a class in China?

While Figure 3, "Relationship Between Economic Growth and Political Liberalization," posits the assumed relationship--economic growth leads to a
pluralist democracy, moving China from Quadrant B to Quadrant D—economic growth without privatization in a society that has experienced little democracy could create a managerial class or middle strata of managers of enterprises, conglomerates or companies, who need not support democracy. Add to this a strong ethos in China favoring corporatist property rights and collective interests and we may discover that China's economic growth is creating a corporatist, not democratic state, moving China into the upper right quadrant.

A. Forces against democratization

In China economic power rests with bureaucrats, managers of corporatist economic structures, army officers, semi-public companies, and mayors of towns, cities, development zones and former people's communes (now called townships), who control and manage key sectors in China's exploding economy. As David Wank and Liu Yia-ling have both shown, successful private entrepreneurs build government networks as protection from rapacious bureaucrats who would otherwise plunder their profits and extort funds for their local coffers.¹⁹ These bureaucratic capitalists, working in a climate of crony capitalism reminiscent of Marcos' Philippines or Suharto's Indonesia, are unlikely to create a tidal wave for democratization.
By the end of this decade China will be run by this middle strata of corporate directors and local government leaders who are locked into the extant property rights regime of state or publicly owned industries. These captains of industry will prefer corporatism and soft authoritarianism, to democratic change; if social unrest challenges their property rights, they will support hard authoritarianism, and any crackdown that is necessary to protect public order. Increased marketization suggested by Figure 1 could increase the efficiency of these local government firms, obviating the need for real privatization. Despite assertions that a growing private sector is creating a strong middle class, one actually finds only a limited role for the private sector outside the service sector within China's cities.

In the countryside, where most private firms exist, one finds little support for democratization among the rural business elite. I recall a conversation with a millionaire in southern Jiangsu who had moved his plant from Beijing to the countryside to avoid state interference. While publicly listed as a collective, he paid off the party secretary who let him gua hao or "hang the collective's name." Did he favor democracy? Did he support workers' organizations? You must be kidding. As of 1992, only .5 percent of the millions of rural enterprises at the country or below had trade unions. And even as China's leaders let
farmers elect villager committees nationwide to stabilize the countryside, weaken oppressive cadres, and persuade farmers to invest in public works projects, elections remain ensconced at the lowest levels of rural society and are unlikely to spark a nation-wide democracy movement.

As for political parties, their historical origins suggest several patterns. In Britain, intra-parliamentary factions became voting blocks and then parties, while extra-parliamentary transformations, such as the rise of new classes or worker's movements, also translated into formal party representation. Ethnic groups religions and social movements have also metamorphosized into new parties.

Within the communist world, Hungary's factions within the communist leadership in the 1980s became the genesis of political pluralism as liberalization turned these factions turned into competitive parties. In China of the 1980s, stark differences over development strategies among clear factions each possessing their own journals, made such a scenario plausible. But China of the 1990s may be different. While factional disputes are emerging, with Qiao Shi apparently seeking the reformist high grounds, Jiang Zemin's struggle to maintain his legitimacy as the "core" of the leadership makes concessions and institutionalized division of authority difficult. And even in 1987, the
liberal Zhao Ziyang tried to drive hard liners like Deng Liqun out of the Central Committee and close the hard liner's magazine (Hongqi), rather than institutionalize policy debates and pluralism within the communist party.

Do foreigners undermine or support the middle strata? Throughout urban and rural China, FDI is partnered with local governments or the PLA at all levels of the system. Rather than undermine government authority, as long asserted by leftist critics of multinational corporations, foreign investment, rural research, including my own field work, shows that FDI strengthens government legitimacy by increasing economic growth and helping local governments meet their social welfare function. Pearson also found that Chinese managers in the foreign sector are also no future source of political liberalization.

Finally, Tiananmen sent a clear message to the Chinese people. Public protest will be met with violent counter force, and the people's army will fire on the people. Since then most Chinese have accepted the government's offer to seek private interest through business; to seek freedom through amassing wealth; and to maintain economic growth through political passivity. Chinese look at the chaos of the former-USSR and their own country's economic vigour and say: "there but for fortune go I."
**Forces for democratization**

Yet powerful forces push on the walls of China. As Huntington has shown, a wave of democracy has been sweeping the world, though it does appear that the tide is receding. A more open relationship with Hong Kong could generate an even stronger demonstration effect from overseas, although in the short run political freedom in Hong Kong will be fighting its own uphill battle. The confluence of three factors--corruption, inflation, and an economic recession--could trigger massive protests, with strong popular support, as in 1989, when 30 percent inflation dropped real incomes for Beijingers, even as a *nouveau riche class* emerged. Such protests could cripple the system if not lead to its collapse. But in the absence of alternative political parties a democratic regime need not emerge; such a collapse would most likely give rise to a military dictatorship.

Growing regional power is generating change in the Chinese system. A weaker center could lead to a more pluralist political system where provincial interests seek political expression through a more vibrant, truly federal, National People's Congress system. But few careful observers expect the NPC in the short run seriously to challenge the Politburo, the power center of Chinese Communist Party.
Conclusion

Over the medium term, China's progressive liberalization is likely to develop most extensively in its foreign trade sector. Foreign influence, foreign investors and the United States government, all influence China's leaders' calculations. However, despite its rhetorical value, external pressure has little direct impact on internal political change except to help a few famous dissidents get out of prison and perhaps leave the country. Thus China's entry to the WTO is critical, both for the concessions that can be squeezed out of it before entry, and for the ongoing pressure that will be exerted by China's participation in the regime. Nevertheless, even after China joins, its bureaucrats will prefer the upper right quadrant, where they can better control the direction of its global trade and technological development.

Trade liberalization brings foreign competition and demands for domestic market liberalization. Joint ventures, with economies of scale and high quality products, as well as efficient Chinese companies, are undermining regional protectionism. But don't look for this change to occur over night; regional interests both constrain and promote domestic market liberalization.
But while markets are powerful and challenge economic institutions that resist liberalization—who 10 years ago would have thought China's economy would be so open today—political liberalization does not appear on the national agenda. Too many vested interests would be threatened by a free press and public disclosure of the activities of China's middle and upper strata.

Could the system collapse? One lesson of Tiananmen is that corruption, inflation, and economic stagnation can seriously threaten the system. Michael Johnston differentiates between "integrative corruption," which greases a system calcified by institutional constraints, and "disintegrative corruption," which infects and corrodes the spirit of a people and the legitimacy of their government. Today China generates too much of the latter, even as the former facilitates market liberalization. I am reminded of Albert Hirschman's tunnel metaphor, where drivers can tolerate others passing them if they themselves are moving forward. They will abide by the rules and the double lines that proscribe crossing lanes. But should their line of traffic stop—as when inflation and stagnation propel real incomes into a tail spin—formerly complacent drivers suddenly jump the queue, crash into the passing cars, and bring the whole system to a calamitous collapse.
If the past is any guide, China will continue to change, albeit very slowly. China will remain in the upper right quadrant in all three sectors, even though it will move down towards the lower right, first in its transnational economic exchanges and then in its domestic economic ones. Economic data remains optimistic, making economists and business leaders the most upbeat about China's future. Yet some political scientists, particularly those who believe that economic development cannot continue without political liberalization, remind us of the high price China will pay if, in the absence of political liberalization, corruption persists and the economy stalls. One can only hope that China's leaders will continue to liberalize all sectors before this scenario becomes more likely.
ENDNOTES


