

From Economic Liberation to Political Suppression: 1979-1989

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The Background

In the last decade China undertook very drastic economic reforms, many of which were unprecedented in the history of socialist development. It was truly a period of economic liberation. International contacts were encouraged; a market economy to allocate resources and private ownership was established in many sectors and regions; and decision making was decentralized to allow local authorities to deal with such important matters as foreign trade, foreign investment and capital construction.



The first half of this 10-year period, i.e. from 1979-1984, proved to be most gratifying, as agricultural output rose at a very rapid rate. The average growth rate of less than 5% for the period 1953-1984 increased to more than 10% from 1979-1984. This coincided with the rapid development of rural industries and agricultural by-products, which increased the farmers' per capita income tremendously. During this time, China was able to attract a significant amount of foreign investment to assist in building up its infrastructure and upgrade its production technology. The foreign trade slice of the gross national income also increased dramatically, signifying China's emergence in the world economy.

Problems with economic reform and modernization began to arise in late 1984 when China decided to extend its agricultural reforms to include the urban and industrial sectors. In general, they came from a failure to understand the preconditions required to carry out successful reforms in these areas. What followed was increased trade deficits, a widened gap between government revenue and expenditure, and bottlenecks in the distribution of raw

material and fuel supplies, which resulted in a grossly overheated economy accompanied by severe inflation. By 1988, the situation became so bad that the Chinese leaders had to reassess the direction and pace of their economic reforms.

Heated debates must have taken place privately among Chinese leaders about whether the reformist policies of Deng Xiaoping and Zhao Ziyang and their associates ought to give way to the more conservative policies of Chen Yun, Li Peng, Yao Yilin and their associates, for the split in leadership soon became public as the power struggle between the two groups increased in severity. Conservatives were gradually winning the upper hand--illustrated by Li's appointment as Premier to replace Zhao Ziyang who became Party Secretary General. The ensuing economic chaos, political discontent and social injustice led to a rising feeling of dissatisfaction with the government among the people, and as is usual in such situations, this was felt strongest among students and intelligentsia.

While the death of Hu Yaobang provided the immediate occasion for the outbreak of the student movement, which led to the occupation of Tiananmen Square during April and May of 1989, the massacre of June 4 was more the result of the on-going power struggle between reformists and conservatives than the student protest movement itself. It is certainly plausible that in the beginning, this was a spontaneous movement among the students, but in its later stages it must have been fueled by reformists in one way or another. Reformists thought that their declining power could be refurbished by the students' attack on the policy of the conservatives. As a consequence, the conservatives had no other choice but to use force to end the student movement and usurp the power of the reformists.

The terms "reformists" and "conservatives" are used here in a relative sense. The conservatives are certainly not entirely opposed to reform, but they certainly support a much slower pace of reform, advocating a smaller state market economy and limitations on the private sector to uphold the socialist principle of public ownership. Above all, the conservatives are in favour of a much higher degree of centralization and government planning; many have been trained in the Soviet Union and can be called Stalinists. Let us turn now to an analysis of political and social factors leading up to the student movement.

The Problems

From 1979 to 1984, great success was achieved in increasing agricultural output. However, it must be noted that this was largely

a one-time only increase which came from the introduction of the "responsibility system" and the increase in procurement prices for agricultural products. The "responsibility system" allowed farmers to earn money through sale of produce left over after fulfilling their state quotas. This provided a greater incentive to put more work effort into farm production. Also, the drastic increase in procurement prices provided a further incentive for farmers to produce more. However, such increases in output are necessarily a one-shot deal when no fundamental changes are undertaken to develop agricultural technology.

Farmers invested their savings largely in rural industries and in nearby urban profit-making schemes. As a result, despite the dramatic increase in the farmers' per capita income, the level of reinvestment in agriculture was very low. Under such conditions agricultural output could only be expected to decline in the absence of fundamental technological changes and improvements in the agricultural infrastructure. Indeed, grain production reached its peak of 407 million tons in 1984 and since then has been decreasing.

When agricultural growth began to lose steam, it was logical for the Chinese government to extend agricultural reforms to industry. Industrial and urban reforms were introduced in 1985. The reformists, however, failed to recognize that the urban situation was quite different from the rural setting. In the first place, bureaucratic obstacles are much greater. Vested interests are much more entrenched in the urban sector when compared with agriculture.

More importantly, industrial and urban reforms bent on giving more autonomy to corporate enterprise and place more emphasis on market forces in the allocation of resources require certain preconditions if they are to be effective. One of the most important of these is the presence of a competitive market environment where large numbers of buyers and sellers are free to enter or exit at will. This implies the presence of a lively private sector dominated by private ownership. This condition was not present either at the time or during the reform period. Privatization and the decontrol of prices often resulted in the creation of monopolies which reaped inordinate profits.

Successful industrial and urban reforms also require a high degree of mobility in those factors governing input so that production can respond to fluctuations in supply and demand. Unfortunately, the supply markets were not deregulated to the same extent as the product markets. The capital market remained underdeveloped and the mobility of the labour force was highly restricted in the urban sector. Above all, the allocation of strategic raw materi-

als and machinery was in the hands of the state monopolists and only those enterprises with the "right connections" were able to obtain an adequate supply.

Also, the flow of basic information was far from perfect in the urban markets of China. Market information can vary even within the same market and the information flow was extremely slow. As a result, the response of production to market changes was sluggish to say the least.

To compensate for the spiraling rise in the cost of living and to give additional incentives, workers wages and bonuses were increased by further funding from the government budget. This increase was financed basically through creating more credit or simply by printing more money. The money supply increased at an average rate of about 40%. Prices were not only pushed up by higher agricultural costs but also the price reforms, which accompanied industrial and urban reforms, led to an extremely rapid rate of increase in prices everywhere. This has to be the case whenever prices are kept under rigid control for a long time as had been the case in China for three decades. In the absence of any macroeconomic instruments to tighten fiscal and monetary policies, there is simply no way to stop the inflationary spiral from continuing.

There are also other reasons for galloping inflation in China. First, the exchange rate of the Chinese *yuan* has been grossly overvalued, greatly increasing imports of both capital and consumer goods. Second, the Chinese government took steps to decentralize decision-making to the extent that the Central Government was no longer able to control the amount of capital construction in the different provinces and counties. This was especially true in regions along the coast where local authorities were able to keep a large share of the foreign exchange they earned. Regionalism almost wiped out inter-regional trade in China. Lack of specialization, of course, reduced production efficiency and the level of output. Thus, by 1988 China reached the stage where neither the market system nor the centralized planning system was operable.

The reformists were unable to build a foundation on which industrial and urban reforms could take place. At the same time they destroyed the traditional controls central planning had over the allocation of resources, which had proven effective in the past. The Chinese economy became, then, a most undesirable hybrid of the socialist and the capitalist systems. One may go so far as to say that China took the worst from both worlds and ended up with no system at all. It was, therefore, no surprise to find China in serious crisis by the beginning of 1988. A new direction had to be taken. With hindsight, we can judge Deng, Zhao and other reformists guilty of very serious mistakes in formulating and implementing

reform policies. There was, therefore, some justification for the severe attacks the conservatives launched against them. Economic chaos gave the conservatives a perfect excuse to get rid of the reformists. But during the years of change the reformists had been building up a power base in all parts of China. Each side then faced stiff resistance and would have to use whatever means possible in overcoming the force of the other. It is not difficult to understand why such a huge mobilization of the army took place in the latter part of May and was deployed against the students in the June 4th massacre. The reformists had the students and most of the people behind them; unfortunately, the conservatives had stronger control of the army.

In addition to the economic chaos, the slow progress of political reforms vis-a-vis economic reforms had given rise to great discontent among the intellectuals, who had had extensive exposure to Western ideas since the opening up of China. Even so, the intellectuals were not aiming to overthrow the Communist Party; they simply wanted to see a more democratic system within the Communist Party. Also, when calling for political reforms, many were, in fact, referring to reforms in the administrative system. Economic opportunity had given rise to extensive corruption and nepotism within the Communist Party and the civil service. The intellectuals were not demanding a Western style multi-party political system; their greatest grievance was the corruption of government officials. While corruption at the lower levels could be tolerated, it was really frustrating to see it rampant at the very top level of leadership. In early 1986, sporadic student protests were easily suppressed because the students' movement had not yet gained momentum and the degree of government corruption and economic chaos was less severe.

Certain social factors are also important when analyzing the reasons for the outbreak of the student protests in the Spring of 1989. A serious cause of discontent was the widening inequalities in income both horizontally among regions and vertically among different groups of people and professions in a given region. The entrepreneurs in the private sector emerged as the winners in the economic reform game, while wage-earners engaged in the service sector, especially those in the civil service and education lost out in relative terms. Problems of income inequality are more serious in China, than in other countries where there are mechanisms for redistributing wealth. The tax system which is not based on the ability to pay, is far from perfect and tax evasion is very widespread. At the same time, China does not have an effective social welfare system to protect the unemployed and under-privileged.

Failing to provide adequate expenditures for education was

another serious mistake made by the government. The government went overboard to "privatize" education i.e., locating funding responsibility on the institution. Investment in human capital is recognized as a *sine qua non* in promoting economic development and future growth but the rate of return to the individual is so low in China that few are willing to invest in an education, even in top universities. The low wages that academicians receive have a demoralizing effect. It is therefore, understandable that the intellectuals became highly dissatisfied with the government policies and played an important part in the student movement.

Thus, in view of the economic chaos gripping the country and the political and social discontent among the intellectuals (and to some extent the general public), the rise of the student movement and the occupation of Tiananmen Square came as no surprise. At the same time, in view of the bitter power struggle among the leaders over conflicting policies, the hard-line action taken by the conservatives to end the whole matter could only have been expected.

The Future

The suppression of the student movement and the sacking of Zhao imply, of course, a victory for the conservatives under the leadership of Chen Yun. It is interesting to note that Deng, in fact, comes out the loser in this whole thing. Because Deng is the true architect of China's reforms and the leader of the reformists, his power could not possibly be overthrown. He retains his unchallengeable position in the party, the army and the nation as a whole. But it is sad to see the two men he hand-picked to succeed him shoved aside one after the other. It is possible that during the events of the student movement, Deng was misadvised by the conservatives with the result that he gave his consent to the forceful suppression of the movement, and there seems to be more than a grain of truth in reports that Deng to some extent regrets his decision. That Deng through the years was able not only to survive but to return to power three times after being purged verges on the miraculous, but unfortunately, with the massacre the heroic image he had created for himself will never survive.

For the next two or three years, the political situation in China will remain unstable, nevertheless with a certain stability. This means that in the short run the existing regime will be able to maintain its power, but in the long run, another crisis is most likely to occur. At present, China is really ruled by the old guard, eight old men who are all over eighty years of age. Of these, seven are basically conservatives. In other words, we have a situation of one

against seven in the balance of power in the leadership. But the one is Deng Xiaoping. It is expected that as long as Deng is there, he will serve as a check and balance on the power of the other seven. Another power struggle will take place when the reformists have regained enough momentum and support of the people and the army to force a confrontation. How soon this will be depends on how soon the eight old leaders will pass away. While both Chen Yun and Deng are not in the best of health, many of the old guard conservatives are still quite strong. It is expected that the present conservative regime will stay in power for at least another two to three years.

It is important to understand that in the present world of Chinese politics, as long as the Communist political system does not change, cyclical changes in leadership brought about by power struggles are inevitable. There cannot be any long term political stability in China because political chaos breaks out at regular intervals due to unresolved power struggles within the party. Power struggles are ruthless, hard and unscrupulous in Communist politics because under such a system, the losers are not only stripped of their political power, but they and their families are also disgraced and subjected to persecution. Long term political stability cannot be achieved by changes in leadership, but only through fundamental changes in China's political institutions.

In terms of the economy, it is expected that the present regime in China will try to keep the door open for foreign investment and international trade. This is necessary if China is to maintain some degree of economic progress in the coming years after years of chaos. More importantly, China will face the peak period for repayment of its international loans in two to three years time, at which time hard foreign currencies will be greatly in demand. But it will be difficult for China to recapture the same enthusiasm among foreign investors it had in the past. China is now viewed as a high risk country for economic investment. While foreign investors will continue the projects to which they are already committed, they will be reluctant to take on new ones for some time to come. Another deterring factor is that in the coastal cities, which have been more open, the officials-in-charge who have been by and large Zhao Ziyang's men will soon be replaced. The newly appointed officials will of necessity have to be more conservative and cautious in their management of external economic relations.

One cannot be very optimistic about China's economic outlook because it faces serious capital and manpower problems. As a result of the purge of the intellectuals after the suppression of the student movement, China has lost a large number of its already scarce supply of human resources necessary for modernization.

There are at present over 100,000 Chinese students and scholars studying abroad. Few of them will return to China as long as the existing regime is in power. It will be extremely difficult, if not impossible, for China to replace their skills in the near future.

There is little question that in terms of ownership and the allocation of resources, China will revert to the socialist system of public ownership and centralization of planning. The importance of state enterprises will be reemphasized, and authority previously vested in local governments will be withdrawn significantly. In the short run, the reversion to centralized planning, in view of the economic chaos of the past few years resulting from a lack of effective control by the central government and the absence of an effective market economy, might make the Chinese economy less overheated and inflationary. However, in the long run, such a reversion will not provide high incentives for production in either agriculture or industry. Prices may not increase at the fast pace of the past few years, but inflation, although suppressed through an inadequate supply of goods and services to satisfy the prevailing level of purchasing power, will still take place.

The Chinese economy is vast and complex. Neither a Stalinist, highly centralized economic development strategy nor a one-stage, simplistic open-market policy can make the Chinese economy work. China must opt for gradual, step-by-step institutional and economic reforms. The following are some suggestions that could help China realize this goal:

1. Administrative reforms of the civil service system at the central and local levels.
2. Privatization of state and collective enterprises and liberalization of the factor input markets so as to create a competitive micro-economic environment for market forces to function.
3. Establishment of financial machinery and institutions; implementation of fiscal reforms, so as to enable the central and local governments to operate with effective macro-economic controls.
4. Introduction of the allocation of resources through market forces and price reforms.
5. Political reforms.

The message here is that some very important groundwork must be done before price reforms are introduced. Administrative reforms are also of utmost importance; political reforms moving towards democratization should come later. Much can be learned from China's decade-long open-door experience. It is still not too late for China to correct its mistakes if its leaders have the determination to do so.