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CHINA'S NEW ECONOMIC AND  
STRATEGIC UNCERTAINTIES;  
AND THE SECURITY PROSPECTS

by

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## **ABSTRACT**

This paper surveys the implementation of China's 'four modernisations' program during the past decade, when the country's leadership took advantage of a period of comparative stability and detente to develop a broader economic and technological base. It describes the achievements of the program so far and its problems, both internal difficulties resulting from local conditions and problems associated generally with international economic growth and competition. The paper points to tension between the requirements of Party bureaucratic control and the demands of modernisation for economic innovation and political liberalisation, discussing the events of May-July 1989 in these terms. It also points to a new and different economic future world-wide, with the tempo and scale of development posing increasing difficulty in information and investment control. Finally, the paper discusses changes in the strategic balance resulting from national and international economic developments, in particular the emerging role of China as a middle power between the USSR and the US.

## **DISCLAIMER**

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As the world moves towards the dawn of the twenty-first century, a number of new developments seem to be changing the strategic and economic landscape. The competition for faster economic growth and technical advancement has become, at least for the time being, a more important component in an increasingly varied and multipolar field of international politics. Competition for advantage in these terms will, inevitably, also lead to strategic changes in providing enhanced possibilities for military and strategic assets, across a wide range of capabilities from the advanced conventional to the post-nuclear strategic field.

Among the major actors in this changed calculus of strategic competition the People's Republic of China is an especially interesting case. Strategically, China is once again assuming the role of a "middle power" between the US and the Soviet Union. Economically, she is embroiled in a development program of unprecedented variety and scope, one which also harbours unprecedented possibilities for an expansion of Chinese power and influence in the future. Under the "four modernisations", China is engaged in the rapid development of her agricultural and industrial economy and, at the same time, pursuing diplomatic and military policies designed to maximise China's assets and manoeuvrability in the new and more complex international environment.

From the point of view of analysts in Beijing, the world situation, and the superpower relationship, look relatively stable for the foreseeable future. As one senior Chinese observer has put it:

The East-West cold war is approaching an end, the world economy is continuously going towards integration, the interdependence among various nations becomes more obvious, and there emerges a positive trend towards relaxation.<sup>1</sup>

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<sup>1</sup> Xu Kui, 'The Prospects of Sino-Soviet Relations', *Foreign Affairs Journal* (Beijing), June 1989, p.30.

The US has serious domestic economic problems and her relations with allies in Europe and Asia will be more difficult to manage in a period when Congress and the US public are disposed to be inward looking. Other problems, including those of relations with Japan, or of Central America and Mexico, are likely to absorb more American energy and attention. The Soviet Union, for its part, has much more serious problems still. The Soviet economy requires radical reform from a system, and a group of officials, who have neither experience of or sympathy for such an enterprise. The political and other costs of the needed transformation are such that it remains unclear whether the Soviet system can manage them at all; if it does not, the decline of the Soviet Union as a major power is inevitable. Yet Mr. Gorbachev, in a brilliant series of foreign policy moves, has used his domestic reform impulse also to undermine the sense of threat which was the cement of the western alliance and the source of American leadership and determination to resist Moscow.

Nevertheless, Beijing believes that the current Soviet-American detente has its fragilities. America's sense of economic and technical superiority might tempt it to be adventurous; on the other hand, the US is likely to be restrained by domestic problems, as Mr. Gorbachev will be constrained by his own domestic troubles. The conclusion is that there is likely to be a period of stability in relations between the major powers during which China can concentrate on her own domestic objectives. At the same time Beijing's ability to play off the superpowers against each other will be correspondingly reduced.<sup>2</sup>

It is also likely, in Beijing's view, that China's immediate security environment will be stable. The Soviet withdrawal from Afghanistan and events in Cambodia tend to bear out these assessments. The Soviet interest in reducing obligations in Vietnam points in a similar direction. Moscow clearly understands that by improving relations with China several objectives might be advanced. One is the need to transfer substantial resources from the military to the civilian sector. Others have to do with

<sup>2</sup> Zi Zhongyun, *The Situation Tends to Become More Relaxed, But Contention Remains Dominant*, Shijie Zhishi, 16.9.1988, FBIS/PRC 13.10.1988, pp.5-8.

the desirability of enhancing the Soviets' standing in Asia generally, the need to detach China somewhat from the USA and also from Japan, to ease the traditional Soviet worries about two-front confrontations and to improve his political position at home by showing that he, alone among recent Soviet leaders, has been able to end the Sino-Soviet conflict and contain the potential threat from the Southeast. Mr. Gorbachev has, in fact, shown much more than diplomatic flexibility. He has accepted the Chinese position in the dispute over the Amur River border and made major concessions on China's declared three obstacles to any normalisation of Relations: the heavy Soviet troop deployments on the Sino-Soviet border, the former Soviet occupation of Afghanistan and Soviet support for Vietnam's occupation of Cambodia. All that is in sharp contrast to Soviet policies a mere two or three years ago. But he has gone further. In December 1988 Chinese Foreign Minister Qian Qichen visited the Soviet Union. This was followed by visits to Beijing by Soviet Foreign Minister Eduard Shevardnadze in February 1989 and by Mr. Gorbachev himself in May. Gorbachev has also responded in a highly intelligent, if hard-headed, way to the events in Beijing in May/June 1989. He has clearly refused to condemn the repression of dissent. That refusal may well, in part, be due to his own fears about growing dissidence in the Soviet Union's internal and external empire. His silence vis a vis Beijing has sent a clear message to everyone in Eastern Europe and the Soviet Republics: "In the end, the rule of the Party will not be allowed to be challenged." But, at the same time, he has said to the leaders in Beijing: "We will not try to take advantage of any temporary difficulties you may have. We understand." He has therefore also invited to ruling groups in Beijing to contemplate the contrast between emotional condemnation in the West and, in effect, fraternal understanding in Moscow. Here, too, the unspoken message is clear: "In the end, it is only the Soviet Union, your fellow Socialists, whom you can rely on. Let us therefore cement our relationship."

A limited accommodation is also evidently in China's interests. It diminishes, at least, for the time being, the dangers from a Soviet Union whose power still encircles China. It would allow China to maintain her

relationships with Japan, the US and the rapidly growing economies around the Pacific. And it would give China increased freedom of movement as between the US and the USSR.<sup>3</sup> Beijing has therefore put some stress on the need for both China and the Soviet Union to concentrate on socialist reform, the desirability of better bilateral relations between them, and the exciting possibilities for an expansion of trade and other economic and cultural exchanges. The original Sino-Soviet dispute was unnecessary and an "historical tragedy". But Beijing has also emphasised that an improvement in Sino-Soviet relations must not be at the expense of other relations, that the coming restoration of Party relations must remain subordinate to state-to-state relations guided not by ideology but by national interest, and there can be no restoration of the Sino-Soviet alliance of the 1950s.<sup>4</sup> In sum, Chinese military and civilian analysts believe that, at minimum, both the US and the Soviet Union are concentrating on economic reform in order to prepare for a future of renewed competition in which economic and technical capabilities will play an increasingly important role as the foundation of military power. The current period is a respite, which should be wisely used to strengthen China's own position.

For all these changes, China recognises that the rapid development, around Asia, of economic and technical prowess will also produce military capabilities contending for advantage in what is likely to be a somewhat volatile and unstable environment. That underlines China's need to concentrate on domestic economic reforms so as to create the basis for greater general capabilities later on.

Looking around at the situation in Asia and the Pacific, we should have a sense of crisis, of urgency and of seriousness. This is because

<sup>3</sup> See Donald Zagoria, *The Sino-Soviet Detente and its Implications*, paper presented to the National Defence University Symposium "Evolving Perspectives for Pacific Basin Strategies in the 1990s and Beyond", Honolulu, 2 March 1989 (hereafter referred to as "NDU Symposium") (mimeo); also *The Weekend Australian*, 10-11.9.88., p.13.

<sup>4</sup> Xu Kui, 'The Prospects of Sino-Soviet Relations', *op.cit.*, Yang Shouzheng, 'Sino-Soviet Relations: Part, Future and Implications', *Foreign Affairs Journal* (Beijing), June 1989, pp.22-27.

certain countries and regions around us are developing rapidly with Japanese and US capital and technological assistance ... If we again fail to seize the opportunity and to go all out to make the country strong, we may lag far behind after ten years ... The 1990s are the key decade ... If we fail to make good use of those 10 years ... we will be in great danger.<sup>5</sup>

As time goes by, new powers will arise and the "contradictions" among them will intensify.<sup>6</sup> The Asia-Pacific area can be expected to become, increasingly, the central focus of contention among the major military powers in such a period of transformation.<sup>7</sup> Within Asia itself, Chinese observers are concerned about Japan's growing military power.<sup>8</sup> Chinese reports on Japan's fiscal 1989 plans have focussed on spending on anti-submarine warfare technology and on the plans to develop a next-generation fighter aircraft. The various programs are expected to be promoted by a Japanese defence industry hungry for large profits.<sup>9</sup> Accordingly, Chinese observers tend also to interpret Japanese policies in Asia, Southeast Asia and the Middle East as evidence of an intention to establish Japan as a major political power and the central element in Asian economic relations. They even suspect Japan of wanting to establish a position in Vietnam - following moves towards some Japanese economic presence there - from which to contain Chinese power in the future.<sup>10</sup>

No doubt all problems of this sort might become more acute if foreign powers were to interpret the events of May/July 1989 in Beijing as raising new questions about China's internal political cohesion. Using the coming

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<sup>5</sup> A Special Yearender: A Year of Turbulence, Change and Disquiet - Huang Xiang Reviews the International Situation in 1987, Renmin Ribao, 31.12.1987, FBIS/PRC, 5.1.1988., p.4.

<sup>6</sup> Xinhua 20.7.1986., FBIS/PRC 22.7.86., pp.K1-3; also Xinhua 4.12.87., FBIS/PRC, 7.12.1987., p.29.

<sup>7</sup> Xinhua, 6.12.88., FBIS/PRC 7.12.1988., pp.11-12; also Liaowang 17.10.88., FBIS/PRC, 27.10.88., p.6.

<sup>8</sup> Commentary, Japan Molds Public Opinion for the Dispatch of Troops Overseas, Xinhua 14.4.1988., FBIS/PRC 19.4.88., pp.16-17. Also *The Economist*, 6.8.88., p.18.

<sup>9</sup> Xinhua 24.5.88., FBIS/PRC 27.5.88., pp.7-8; also Jiefangjun Bao 18.6.88., FBIS/PRC 29.6.88., p.14.

<sup>10</sup> Tian Di, Trends of Japan's Diplomacy Toward Asia, Shijie Zhishi 16.10.88., FBIS/PRC 2.11.88., pp.13-15.

period of relative calm to strengthen China's position therefore means several things. In the first place, it means restoring and strengthening central Government and removing any domestic or foreign doubts about either its cohesion or its legitimacy or authority. It also means, as Chinese spokesmen and analysts have said, stressing China's desire for friendly cooperation with states of all kinds of social systems, emphasis on state relations rather than Party or people-to-people relationships, and a revived stress on the principles of peaceful coexistence.<sup>11</sup> In addition, China must make a diplomatic effort to support superpower moves to stabilise regional affairs and to reduce or manage regional crises. It also means, at home, focussing on industrial and financial modernisation while, at the same time, strengthening the foundations for military modernisation. In a period when war is unlikely and the services have a much lower priority in claims on the national budget, with the funds available the military leadership has nevertheless made important strides in developing China's military capabilities.<sup>12</sup> But it is also obvious that any closer assessment of China's external clout and military capabilities depends on some grasp of her technical and economic development.

What, then of the economic development policies which have been pursued in this kind of context? It was ten years ago last December that a meeting of the Central Committee of the Chinese Communist Party launched China into a period of economic reform. Soon afterwards, her leaders began to talk of quadrupling production per person by the end of the century. And in that decade, China has indeed, according to official statistics, doubled her output. It has been a rare achievement.

The reasons are many and can be debated. One is the considerable degree of social cohesion in China, whether voluntary or contrived. A second is the very high value now placed on formal and disciplined education and training. Another has been China's ability to increase the labour force and

<sup>11</sup> Han Nianlong, 'Five Principles of Peaceful Coexistence Shine Forever', address of March 1989, reprinted in *Foreign Affairs Journal* (Beijing), June 1989, pp.14-21.

<sup>12</sup> See Zhang Aiping, *Peacetime National Defense Buildup*, Junshi Wulin No.4, 1987, FBIS/PRC 17.9.87., pp.12-16.

to provide it with improved machinery (although, significantly, there has been no visible improvement in the efficiency with which the factors of production are employed). Another has been a relatively high - perhaps very high - rate of savings and investment. Another again is an acceptance of rapid change in the relative importance of industries: a capacity to transform. Another again has been the fact that the recent upward trends in Chinese growth started from a very low base. And one of the most important has doubtless been the way in which the rural economy has been encouraged and has grown. Food production has grown markedly, partly as peasants were given greater control over marketing. Though these marketing developments have been hampered in some areas through control by State agencies, peasant incomes have risen everywhere and very sharply in some regions. Between 1985 and AD 2,000 the PRC wants to double average rural incomes from just under 400 yuan to 800 p.a. All this with official encouragement to rural industrialisation, the development of new towns and the introduction of more modern technologies. Obviously it is essential to increase rural production and productivity to cater for China's growing population as well as the growing demand, as incomes rise, for more and higher-grade foods and fibre.<sup>13</sup>

Advantages have also come from China's capacity to enter the international economy, in the first place by the export of labour-intensive goods produced by cheap labour. This strategy has permitted the financing of imports of needed raw materials and food as well as of technology and equipment to sustain the process of growth and modernisation. Indeed, as China's development has gone ahead, it has become more and more evident that its progress depends critically on the technologies, the hard currency and the expertise which only the West and the Asian capitalists can supply. By 1989 some observers calculated that China had approved foreign investment in some 18,000 Chinese businesses, involving contractual investments of over US\$30 billions.<sup>14</sup> At the same time the

<sup>13</sup> K.He on rural strategy, quoted in Xinhua Bulletin 21.9.87; P.Li, Beijing Review 31(7) 1988, pp.14-19; Zhu Xigang and John Chapman, Rural Reforms in China: current challenges and policy aims, Quarterly Review of the Rural Economy, December 1988, pp.404-414; also Fiona Ricardo, The Chinese Economy to the Year 2000: The World Bank Report and implications for Australian agriculture, Quarterly Review of the Rural Economy, November 1986, pp.335-342.

emphasis on trade has made China more sensitive to protectionism in the advanced countries; has, through closer involvement in international financial markets, increased the pressures for internal institutional reform; and, not least important, made China generally more vulnerable to external influences, including regional or global political and economic shocks.<sup>15</sup> Inevitably, too, the process has involved China in balance of payments problems which have, from time to time, been severe and have hampered the entire development program.<sup>16</sup>

Since China's growth took off from a very low base, the high growth rates may not be able to be continued for long, especially following the events in Beijing. It may be that Deng's ideology of growth, which the leadership has sought to introduce since 1978, has taken hold, (now in spite of Deng?). The Maoist legacy, insofar as it represents an obstacle to growth, does not any longer seem to be important.<sup>17</sup> In spite of the recent political upheavals, any constraints on growth from this quarter may not be the most important. Of greater importance will continue to be the Stalinist legacy of economic management, in particular the notion of orienting a great part of production to meet planned targets, and exchanging that production at fixed prices. Much of the reform effort after 1984 was centred on dismantling much of the central planning system and replacing it by a "planned commodity economy" or something much more like a planned

<sup>14</sup> *The Economist*, 24.6.89., pp.70-71.

<sup>15</sup> Pu Shan, *The World Economy and the Asia-Pacific Economic Development*, paper presented to the Seminar on "China, East Asia and the Changing Global Economy", sponsored by the Pacific Forum and the Chinese Association of Industrial Economics, Shanghai 1-3.11.88. (hereafter referred to as Shanghai Seminar) (mimeo); James L. Paddock, *Evolving Trends in the International Financial Markets: Implications for China*, Shanghai Seminar (mimeo); Yuan-Li Wu, *Economic Reform and Foreign Economic Relations: Systemic conflicts in a theoretical framework*, Issues and Studies, December 1986, pp.104-121, est.116.

<sup>16</sup> The austerity measures imposed in 1985, for example, in order to relieve China of a balance of payments crisis, were effective but at the cost of a serious downturn in growth. In 1985 China's deficit was US\$13 billions and in 1987 US\$3.7 billion; her reserves in 1985 were US\$11.5 billion and in 1987 US\$16 billion. *The Economist*, 19.3.88., p.88.

<sup>17</sup> For an interesting discussion of the contrast between Maoist and Dengist principles in these matters, see Bernard Chavance, *The New Development Strategy in China*, China Report, 24:2.1988., pp.113-124; also David Bachman, *Differing Visions of China's post-Mao Economy*, Asian Survey, March 1986, pp.292-321.

market economy. The official aim was rather to have some imprecisely defined range of goods continue to be allocated through planning mechanisms, but having even Government intervention operating mainly through influencing markets. Whether and to what extent all this will persist, remains to be seen.

The difficulties now confronting China's development are very considerable. They involve both economic and political factors and both general ones and ones particular to China's circumstances. And all of them seem likely to become more acute as China advances along the development curve. To begin with, in 1988/89 China began to face problems of economic overheating, with consumer demand stimulated over many years by bonuses and pay well beyond productivity improvements, the promotion of investment by enterprises and local Government, but without adequate financial discipline; consequently problems also of quite severe inflation; of central government budget deficits accentuated by the way in which the centre has allowed provinces to retain a larger share of total public revenues;<sup>18</sup> problems of increasing inequalities between individuals, groups and regions and, by no means least, pervasive corruption. The contradictions in the reform programme of the Deng administration therefore concern those between efficiency and equity, between price stability and growth, between full employment and improved economic outcomes, and between domestic supply and demand and balance of payments problems.<sup>19</sup> The great bulk of products and prices in China remains controlled and administered. And the trouble with administered prices is simple but basic: no-one can know the real price of anything and it is in principle impossible to know whether any particular set of decisions or allocations is genuinely economically efficient, as distinct

<sup>18</sup> According to Finance Minister Wang Bingqian the central Government deficit for 1989 was worse than expected (*People's Daily* 7.7.89.). Central Government spending in January-May 1989 rose by twice as much as revenue, while taxes paid by state firms declined by 38% as compared with the previous year. By IMF standards of measurement, China's projected 1989 deficit will be 35 billion yuan, up from 34.15 billions in 1988.

<sup>19</sup> See Li I-wing in *China Daily News*, 11.12.87., p.2; Hsueh Mu-ch'iao, *Away with Dogmatism and Ossified Patterns*, *Peoples Daily*, 8.12.87., p.2; Harry Harding, *Summary Report, Shanghai Seminar* (mimeo); Paul C. Marks, *Economic Reform in the Countryside and the Rationalisation of Politics in Mainland China*, *Issues and Studies*, April 1988.

from efficient in terms only of someone's preferred plan. Under such conditions, economically efficient resource allocation becomes impossible. On the other hand, once the system of controls has been set and established, and an entire economic system designed to conform to the administered norms rather than to notions of economic efficiency, it becomes enormously disruptive to introduce major change.<sup>20</sup>

Much progress has in fact been made in freeing prices of consumer goods, some raw materials and at the margin some housing, money, foreign exchange and even labour.<sup>21</sup> But the rigidities associated with central planning and fixed prices remain a major hindrance to growth.<sup>22</sup> A great deal of thought has been given in official quarters to how one might dismantle the remaining elements of central planning, but do so without excessive economic or political disruption.<sup>23</sup> Intense debate among academics and senior economic advisers about whether price reform should precede, coincide with or follow full devolution of management

<sup>20</sup> It has been forcefully argued that price reform is not, in fact, desirable as long as the market remains dominated by State-owned enterprises which are essentially immune to market forces. See the work of Zhang Xuejun and Luo Xiaopeng in "Economic Research", outlined in the Peoples Daily and quoted in *The Economist*, 21.1.89., p.28.

<sup>21</sup> And yet the proportion of the workforce employed in the private sector remains very small. *The Economist*, 21.1.89., p.28. *The Wall Street Journal* (2.3.89., p.A 12) suggests that Government factories are responsible for 60% of the industrial output and 70% of the non-farm workforce.

<sup>22</sup> See the views of the China System Reform Institute on the way in which Shenzhen province's trade with Hong Kong was in danger of being stifled by traditional bureaucratic and other practices, quoted in the Far Eastern Economic Review 15.12.88., p.118. Yet the report also says that Shenzhen's gross product grew, over the last eight years, by an average of 47.7% per annum and by the end of 1987 the province was host to 1400 foreign-funded companies.

<sup>23</sup> PRC officials argue, for example, that to freeze market activities would kill off market commercial and entrepreneurial initiative, while to decontrol planned prices would be highly inflationary. It is an obvious dilemma. Various partial solutions, falling short of a total dismantling of controls, are clearly being tried or suggested. On the special development of coastal regions, see Ji Chongwei, China's Strategy of Economic Development for the Coastal Regions, Shanghai Seminar, (Mimeo) for explicit promotion of the idea that different localities must make their own plans for developing an export economy in accordance with local conditions (p.12). And foreign companies can get not just more control over the management of enterprises in which they may have invested, but 50-70-year leases (*The Economist*, 12.3.88., p.65). There have also been suggestions that the Yuan - whose black market value in Dollars is half the official rate - should be devalued and that the State should sell assets and issue bonds. Too high an exchange rate obviously means that China exports goods which are too expensive in local currency terms and encourages the import of goods whose real cost of production is higher than their equivalent Chinese products.

authority to the managers of enterprises had been more or less resolved by 1988 in favour of general priority for enterprise responsibility.<sup>24</sup>

One of the effects of price controls is that they suppress inflation. The problem of excess demand (or, better, previously suppressed demand) has grown worse in the period of reform and been fuelled by high monetary growth in the partially decentralised system in recent years. (In August 1988 the Government decided to suppress the growth in money supply which was reported to have run at a rate of 40% p.a.<sup>25</sup>) In fact, it has proved to be extremely hard to control the growth of money or demand in a partially freed system. It is impossible to limit the calls on the budget by State enterprises which, from inputs at fixed prices, are unable to control the percentage of product they must deliver to the state, also at fixed prices. And, pending further financial and fiscal reforms, wider macro-economic instruments for managing demand are not available to the authorities.

The most sensitive problems of price reform have to do with food. Except for basic quantities of grain, food prices were decontrolled in 1985 but later recontrolled and quotas reimposed for some of the more important commodities. The authorities have more recently been experimenting with various devices to soften the political repercussions of any further measures of decontrol. Food is, of course, a special problem. As incomes rise, so does demand for meat and other land-intensive foodstuffs. Yet the stock of land is relatively fixed and China has the inevitable problem of trying to feed 23% of the world's population from 7% of the world's arable land. Rising incomes mean rising prices. And barring major increases in imports - which would require major foreign exchange problems to be solved - or else much more rapid advances in hi-tech food production than China is likely to be able to command, it is hard to know how to square that circle.

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<sup>24</sup> For one element of the debate, see Sha Ye, *The Role of China's Managing Directors in the Current Economic Reform*, *International Labour Review*, November-December 1987, pp.691-701.

<sup>25</sup> *The Economist*, 10.12.88., p.29; also *The Economist*, 21.1.89., p.28; *Newsweek*, 11.10.88., pp.82-86.

The real dismantling of the originally Soviet-inspired central planning system is an enormously difficult and important business. Yet failure would - or will - seriously damage the prospects for sustained high growth. It would do so both directly, through its economic effects, and indirectly through the constraints which the existing system places on the wide distribution of the benefits of growth through domestic trade. Inflexibility in the central planning system will encourage enterprises and provinces to evade the rules and probably to become more self-reliant. Further, without serious price and enterprise reforms China's export growth will be limited by protectionist responses abroad to what will be perceived as unfair trading.

While the leadership clearly understands the importance of price and enterprise reforms, it is constrained by community reaction to inflation as well as the practical administrative difficulties. In a period when so much of decision making has been devolved to enterprises and provinces that the centre has control mechanisms which are in important respects inadequate, and it probably needs to try to recapture some of its decision-making powers. It is a case of preserving and even strengthening the Leninist legacy of "democratic centralism" which Deng has claimed as one of China's major development assets; and which to this point does not seem to have seriously damaged rapid overall growth, though it may well do so as and when China develops further.

There is the associated issue of the scope of State and collective ownership of land and enterprises. State ownership of land need not be, by itself, a hindrance to efficient development, provided that user rights of sufficient duration can be traded through the market; and in China rural institutions seem to have evolved quite rapidly in this direction. Large-scale natural resource development, on the other hand, seems likely to be much more severely hampered by the clumsy and overly bureaucratised State corporations which control these areas. Altogether, the dominance of large State enterprises, some with millions of employees, is clearly a major source of rigidities in the economic system.<sup>26</sup> One must wait to see how

swift and effective are moves to implement previously announced intentions of breaking them up and of moving towards enterprise responsibility.

It is, however, necessary to mention briefly some of the enormous difficulties, not just in controlling and directing the Chinese economic system, but even in effecting basic measurements. Western scholars have attempted, on the basis of Chinese official statistics and the more clearly measurable quantities, such as visible foreign trade, to develop complicated econometric assessments of the Chinese economy and estimates of Chinese growth.<sup>27</sup>

All such estimates are guesswork. No-one, in fact - not even the authorities in Beijing - can know within quite wide margins of uncertainty what China's national product is and the uncertainties of measurement can only increase as China, initially the coastal provinces, becomes more closely interlinked with the international economy. It is, as I have argued in detail elsewhere<sup>28</sup> a startling paradox that in an age of increasingly complex statistical and econometric assessments, and of unprecedented computing capabilities, we know less and less about some important measures of national economic performance. Traditional accounting systems simply no longer reflect what is happening. Indeed, in my opinion many of the major aggregates in terms of which our judgements of national and comparative economic performance are formulated are arbitrary, inadequate and questionable. By way of example, I believe that it can be shown that no-one knows to within at best half a trillion dollars what the real GNP of the US actually is. Unexpected, even unwanted,

<sup>26</sup> Former Communist Party Secretary-General Zhao Ziyang is reported to have advised some visiting Africans frankly "Don't follow China's footsteps in developing so many State concerns. Let private enterprise flourish." *Wall Street Journal*, 2.3.89., p.A 12. For a discussion of the general relationship between initiative and State planning, see also *Far Eastern Economic Review*, 29.1.87., pp.10-15.

<sup>27</sup> See, for example, Albert Keidel, *China's Economy in the Year 2000*, in David M. Lampton and Catherine H. Keyser, *China's Global Presence*, Washington, American Enterprise Institute for Public Policy Research, 1988, pp.67-79.

<sup>28</sup> H. Gelber, *New Patterns of Power Politics : Impact Upon Pacific Basin Security*, paper delivered to the National Defense University Symposium "Evolving Perspectives for Pacific Basin Strategies in the 1990s and Beyond", Honolulu, 2 March 1989 (Mimeo).

social changes can seriously affect GNP calculations. Inflation - which is unofficially but reliably estimated to be running at around 30% or more in China<sup>29</sup> - can increase the numbers doing work and therefore the growth of the apparent GNP. The world economic community has very poor criteria for measuring qualitative improvements in output. We are even worse at measuring intangible movements or even investment in knowledge. Yet in knowledge-intensive areas, which are of increasing importance in China as elsewhere, the importance of intellectual capital has sharply increased relative to investment in plant and equipment; and capital investment represented by education ought to be a major factor in all investment calculations. We are equally poor at measuring unpaid as distinct from paid work. There is also the huge and unresolved problem of how to measure public sector productivity.

But quite apart from problems of measurement, there are huge difficulties in trying to assess, let alone control, the Chinese economy. These problems are as much political as economic for in China, in some ways even more so than in many other countries, all major economic issues are essentially political. Both macro and micro-economic management involve not just political debate but, of necessity, views about the wisdom of leading groups, even of the Party itself. And at other levels, there are the problems of the cash economy, of tax evasion and of the sheer inadequacy of the information available to Beijing about events and movements in all the provinces.<sup>30</sup> By the end of 1988 the central Government, alarmed by the inflationary trends, had proclaimed a new austerity program including a prohibition on further price rises for two years, no more credit for non-productive investments and real punishment for farmers who do not meet their pork and grain delivery quotas. Not only was there to be no new lending but in many areas farmers were being paid by local authorities, not in cash but in (interest bearing) IOUs. But while credit may be tight in some places; especially inland, Government controls in some of the coastal

<sup>29</sup> See *The Economist*, 10.12.88., pp.27-29; 21.1.89., p.28, *Wall Street Journal*, 1.3.89., p.A 11; 2.3.89., p.A 12.

<sup>30</sup> On the misleading character of official Chinese figures see, for example, *The Economist*, 5.3.88., p.30.

provinces seem to be a resounding failure. Guangdong province, for instance, has plenty of hard currency piled up in the 3,000 Hong Kong companies it controls. Altogether, China's investments in, and dealings with or through Hong Kong, seem to be quite inadequately measurable, let alone controllable by the central Government.<sup>31</sup> Nor does the, partly local, cross-border trade with the Soviet Union in China's North East seem to be under close central control, and there are certain to be accounting and reporting problems.<sup>32</sup> Or again, the official figures can hardly take full account of the obviously rather lively economic links between Taiwan and some of the nearby coastal provinces of the mainland.<sup>33</sup> All that can only be accentuated by traditional Chinese ways with tax-gatherers and officials. In Wenzhou, for example, it is reported that there is lots of cash in the hands of traders roaming around the countryside and that a lot more is kept, in the traditional form of cash, in the homes of the very many rich locals.<sup>34</sup> What all that means is that the central authorities must have a very inadequate grip on the whole business of credit-creation, money supply and movements of interest rates and inflation. And the problems are hardly helped by the ethno-centric habits of China's business classes or the difficulties created by China's relatively primitive legal system. So, for example, foreigners have generally found it much harder to make money through dealings with and in China - McDonnell Douglas, Volkswagen and some major Japanese firms have tales to tell in this matter - than Hong Kong and Taiwan groups enjoying the advantages of family and cultural links and a closer understanding of how to deal with frequently corrupt local officials. And, on the legal side, a structure which provides no legal methods for adjudicating disputes between civil and military authorities but, on the other hand, countenances large numbers of executions and the use of torture to extract confessions,<sup>35</sup> is unlikely to be hospitable to sophisticated modern business dealings.

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<sup>31</sup> Far Eastern Economic Review, 23.6.88., pp.64-66.

<sup>32</sup> See *The Economist*, 4.2.88., pp.25-26; 11.6.88., pp.25-26.

<sup>33</sup> For a brief comment on financial links between Taiwan and the mainland, see *The Economist*, 6.8.88., p.74.

<sup>34</sup> *The Economist*, 10.12.88., pp.27-29.

<sup>35</sup> Not to mention such practices as the compulsory sterilisation of people with inherited mental defects. See the Far Eastern Economic Review, 15.12.88., pp.38-39; *The Economist*, 3.12.88., p.30.

The problems are multiplied by other factors. There is the way in which the centre has, as a matter of policy, devolved authority to the provinces and the other technically subordinate bodies. Some freedom has been given to enterprises to retain part of their foreign exchange earnings and the limitations on its use have been loosened.<sup>36</sup> All that has created a number of difficulties. One has been that the share of the national wealth controlled by the provinces has increased over the last decade, while that under the command of the central Government has declined. Another has been the relatively increasing scope afforded to provincial officialdom and local corruption. There are also the mounting problems of growing inequalities between the open cities and Special Economic Zones of the coastal areas - which enjoy special trading, financial and other arrangements - and China's interior. In the SEZs workers earn twice or more what they would get in other Chinese cities.<sup>37</sup> Even an average farmer in Guangdong is said to earn 200 yuan a month, or some forty times what he may have earned back in 1979. Such rapidly increasing earnings in some places, together with increasing inequalities between regions, are likely to contribute not just to inflation and corruption but to discredit the entire reform program in the eyes of some people. They seem certain to create increasing political - as well as economic - differences between coastal and inland areas.<sup>38</sup> Provinces now have, in many cases, their own foreign currency accounts, their own trading arrangements made directly with foreign countries and entities, their own development programs. Given the nature of Chinese bureaucracy, its cumbersome ways and the poverty of intra-Chinese communications, it seems overwhelmingly likely that Chinese provinces and enterprises must choose between full conformity to bureaucratic norms and rapid development<sup>39</sup> and that the centre is poorly

36 See Zhang Peiji, *The New Development of Reforms in China's Foreign Trade Structure*, paper delivered to the Shanghai seminar (mimeo).

37 A senior Chinese official, the Vice-President of the China Academy of Electronics and Information Technology, has remarked that the gross product in Shanghai is US\$1500-1600 per annum whereas in the poorer inland areas it is apt to be "some tens of dollars." Zhang Fu Liang, *Discussion on Development Strategy of China's Electronics Information Industry*, paper delivered to the Shanghai Seminar (mimeo).

38 *The Economist*, 18.6.88., p.25.

39 See, for instance, the critique of traditional bureaucratic and administrative practices in Shenzhen written by the China System Reform Institute and reported in the *Far*

informed about real developments in many places. The point is further illustrated by the recent admission of the central authorities that their population limitation program appears to have failed, at least in part, and that by the year 2000 China's population is likely to be 1.3 instead of the planned 1.2 billions.<sup>40</sup> Even that figure, one strongly suspects, is subject to uncertainties of measurement of plus-minus 70-100 millions.

There are other difficulties. Some are related to the flow of urbanisation. The East-West Center in Honolulu, making "adjustments to official data" suggests that China's current level of urbanisation is 25-30% compared with 18% in the mid-1960s<sup>41</sup> China has 78 cities with populations greater than half a million and 22 with populations greater than 1 million. Although the larger cities have received a disproportionately high per capita share of public investment in urban infrastructure, they are poorly prepared for any acceleration of the flow of people from the land to the cities. That flow is encouraged by the fact that rural incomes remain well below urban ones, a trend which is itself no doubt encouraged by the fact that rural investment remains relatively low since industrial investment is more attractive. The resulting problems are vast. Shanghai, with its twelve million people, has been described as one huge headache, and one made worse by the fact that its economy is dominated by State enterprises and in practice, as distinct from official rhetoric, it is hard to sack anyone.<sup>42</sup> The East-West Center study argues that if Beijing, Tianjin and Shanghai double their annual income per head to US\$2,000 by the year 2000, "they will each want an infrastructure at least as good as exists in the creaky cities of Eastern Europe today. That would require a 2,600% improvement in the provision of sewage treatment alone."<sup>43</sup> Nor do the official figures of urban populations include the millions of temporary and floating workers. That floating population is estimated to be 1.5 million in Beijing, 1.8

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*Eastern Economic Review*, 15.12.88., p.118.

40 Strategic Survey 1987-1988, London, International Institute for Strategic Studies, Spring, 1988, p.154.

41 See Dou Chang, Mike Douglas and Won-Bae Kim, Urbanization and Urban Policies in China: Summary Report, Honolulu, East-West Population Institute, East-West Center, January 1989 (mimeo).

42 *Wall Street Journal*, 22.11.88., p.A 16.

43 Chang, Douglas and Kim, *ibid*; also *The Economist*, 18.2.89., p.30.

million in Shanghai and 1.1 million in Guangzhou. Whatever these (probably unreliable) figures may mean, they surely suggest very large uncertainties about any measurements of economic movements and performance.

Another area of major difficulty is that of education. It goes without saying that China's economic and technological development - not to mention other things, including the development of higher-technology armed services - depends critically on the efficiency and adequacy of the education system. Yet the indications are that much is amiss. Teachers have been protesting about their poor status, bad working conditions and low pay. Pupils of all ages have been dropping out of school because more education does not lead to higher wages. It is reported that some 40 million 6-14 year olds have dropped out in this way.<sup>44</sup> By 1986, on average, manual labourers were earning some 10% more than knowledge workers and illiterate manual labourers were more highly paid than University graduates in many places. A University Professor earns about half the salary of a street trader and his monthly wage is likely to be lower, even in nominal terms, than in the 1950s. A surgeon is likely to earn less than a barber. During the summer term of 1988 in Fujian Province, 853 teachers resigned, causing 148 schools to close and 2,800 pupils to miss classes. One teacher found that he could earn as much in three days selling tea as he was paid teaching for the whole term. Few of those students who go overseas seem to want to return: since 1979 some 36,000 students have gone to the USA and of those only 8,800 have returned to China. It is widely acknowledged that there is a special shortage of trained people in science and the technologies,<sup>45</sup> as well as of skilled workers of all kinds. It is also true that the heritage of the Cultural Revolution continues to haunt

<sup>44</sup> *The Economist*, 26.11.88., p.30.

<sup>45</sup> The point is not new. Back in 1980 Richard Suttmeier, working from the figures of the later 1970s and offering detailed projections to the mid-80s, suggested that the numbers of China's College graduates would increase between 1976 and 1985 from 107,000 to 351,000, the grand total over those ten years being around two million. Of those, at best 1.4 million would be in science and engineering. Those figures - probably optimistic - were in both categories less than half of China's then-projected needs. Of Suttmeier, *Science, Technology and China's Drive for Modernisation*. Stanford, Hoover Institution Press, 1980, table 2, p.55.

China's educated classes. A recent survey in Hubei province of 5,000 intellectuals aged 35-55 suggested that since 1985 one fifth had died prematurely and half the survivors were chronically unwell from the privations they had then endured.

Factors of this kind cannot fail to have a major impact on the speed and character of China's acquisition of high technology capabilities in a variety of fields. In March 1986 the Chinese authorities began work on a "High Technology Research and Development" programme whose results were adopted in March 1987 by the 5th session of the 6th National Congress of the CCP. The goals laid down were to keep up with high-technology developments world-wide, to try to bridge the gaps between China and other countries, to train a new generation of researchers, to make the earliest possible use of research results for the purpose of national construction and to speed up the formation of hi-tech industry after AD 2,000. In accordance with these rather obvious kinds of decisions, China has decided to concentrate, unsurprisingly, on some six or seven areas of technology: biotechnology; space technologies; information technology; laser technology; automation; energy-related technologies; and the production and use of new materials.<sup>46</sup>

It seems obvious that electronic and information technologies will play a key role in China's efforts to develop its high technology base. And while China has made important strides towards creating an infrastructure for electronics research and production, a great deal remains to be done. There have been, and remain, considerable economic and technical similarities between the Chinese and Soviet systems, which may make it more difficult for China to adapt to, or link with, advanced Western and Japanese systems. In addition, China has tended in the past to focus on the military utility of advanced electronics, with the result that speed and memory capacity were emphasised while software and peripheral developments were allowed to lag. Access to foreign technology also lagged. By 1982, when a new strategy for electronics modernisation began to be devised, this

<sup>46</sup> See Pan Bao Zheng and Hu Haitang, On the Strategy of the High Technology Development Programme in China, paper delivered to the Shanghai Seminar (mimeo).

included a general recognition of the productive character of electronics and its potential contribution to productivity gains. Structural reforms were undertaken and a start was made to the necessary upgrading of skills of workers and managers. By 1985 these aims had been expanded to include the acquisition and assimilation of foreign technology by means including joint ventures and other forms of cooperation. Greater attention was to be paid to creating a fully articulated and integrated electronics industry, balanced as between centralisation and decentralisation, and with a greater element of internal competition. The official aim is that by 1990 the electronics industry is to attain a 3.7% share of the gross value of industrial and agricultural output, with annual growth rates of around 16%.<sup>47</sup>

China seems to have some 13 key facilities for manufacturing integrated circuits and eight major research institutes. Total staff number around 40,000 of whom some 5,000 are engineers and technicians. According to Chinese claims, the production of integrated circuits doubled between 1983 and 1985 to 53 million units and it was hoped to increase that figure to 400 million by the year 2000.<sup>48</sup> Similar increases have been recorded in semiconductor devices. Most recent designs are based on American or Japanese technology. The demand for integrated circuits exceeds supply for an industry apparently plagued by quality control problems, high expenses and operating costs and waste of manpower and materials.

There also seem to be some 80 factories which produce computers and associated products and almost fifty which produce computer peripherals. Ten of the 80 factories are considered to be key computer manufacturing plants.<sup>49</sup> There are also some 25 key research institutes. The evolution of the industry has been greatly influenced by domestic political, technological

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<sup>47</sup> Denis Fred Simon, *China's Evolving Electronics Strategy: The role of structural reform and technology modernization*, in Lampton and Keyser, *China's Global Presence*, op.cit., pp.89-113.

<sup>48</sup> See Primer on China's S & T Policy, Beijing, S & T Publishing House, 1986, p.137.

<sup>49</sup> On the organisational side, see Great Wall Computer Group Corporation Established in Beijing, *Zhongguo Dianzi Bao*, 21.3.86, p.1; New Computer Giant Eyes Home Market, *Beijing Review*, 19.1.87., pp.5-6.

and economic factors, as have considerations of self-reliance and technological independence even though a search for real "technological independence" is increasingly impossible, even meaningless, in the modern world. In early 1982 the leadership produced a plan for computer development which would bring China, by 1990, to the same technological levels as those achieved by the advanced developing countries in the early 1980s.<sup>50</sup> Yet Chinese computer design and manufacturing facilities have been considered by most foreign experts to be at least 7-10 years behind those of the US and Japan.

In fact, the gap is likely to be greater still. The Vice-President of the China Academy of Electronics and Information Technology has argued that while China currently has some 4,000 electronics enterprises, most of them are poorly equipped and need their products upgrading; that there is no big investment taking place in developing a hi-tech electronics industry; and that it is likely to take China 40-50 years to catch up with the advanced world in the information industry field.<sup>51</sup> It is also clear, both from Chinese domestic sources and the remarks of foreign observers, that if China is to develop further - let alone rapidly - in these fields, a cluster of efforts will have to be undertaken each of which will be hard to take individually and which, together, will be harder still. They include a willingness to adopt international standards and to produce technology compatible with that of the outside world. This applies most obviously and especially to the development of consumer electronics (also for export) which must go hand in hand with the development of other electronics. If China wishes to develop her capabilities she will also have to establish protection for intellectual property, especially property acquired from abroad. She must begin to participate more fully in world standards and organisational bodies. Her industry must concentrate on producing powerful and reliable hardware at affordable and competitive prices. She must develop an abundance of easy-to-use software, with a strong implication that she must to some extent adapt to the growing importance

<sup>50</sup> Computers in China, Summary of World Broadcasts/Far East (FE/W1201/A/13), 10.11.82., pp.13-14.

<sup>51</sup> Zhang Fu Liang, Discussion on Development Strategy of China's Electronics Information Industry, op.cit.

of the two major world languages in these fields: not only mathematics but also English. And, perhaps one of the most difficult problems, Chinese managers and executives at all levels must be trained and adapted to accept and use the new technologies and their major implications. That will undoubtedly involve political and not merely technical difficulties.

Nor is the electronic field by any means the only one where difficulties will arise. For example, Adam Pilarski has estimated that China currently has the third largest aviation industry in the world, employing over half a million people; and that her domestic air traffic can be expected to increase from 2.96 billion passenger kilometres in 1980 to 43.85 billion in AD 2,000.<sup>52</sup> But what about airport capacity, passenger, luggage and freight handling facilities, what about adequate transport to and from airports and, perhaps above all, what about adequate air traffic and control systems? It would be surprising if China solved all these ancillary problems without difficulty.

As even so brief a sketch makes plain, any kind of planning for China's strategic or economic future is beset by the difficulties posed by these basic economic and infrastructural shortcomings. Perhaps the most acute of these are the human problems of development: the training of technically competent people in all the relevant fields, and gaining practical acceptance of the needed changes in practices and personnel from the people who are now manning the system. In very general terms, China wants to use the expected period of general international stability to develop its economic and technical base and, with that, also her longer-term defence potential. The recent stability on, and the evident decline of dangers to, China's Northern borders has allowed Beijing to reduce the defence budget significantly. That reduction has gone to the point of creating some alarm in China's military establishment.<sup>53</sup> But this has not meant a

<sup>52</sup> Adam M Pilarski, China's Role in the World's Aircraft and Airline Industry in the Year 2000, in Lampton and Keyser, *China's Global Presence*, op.cit., pp. 112-135, esp. Table 5-1, p. 126.

<sup>53</sup> See Chi Haotian, Strengthen National Defense Education and Increase the Sense of National Defense, *Qiushi* No.3, August 1988, FBIS/PRC 12.8.88., pp.47-50; also Yu Yulin, The PLA's Political Role After the CCP's Thirteenth National Congress:

downgrading of modernisation of the PLA. In fact, current and prospective security strategies involve considerable efforts at one and the same time to continue to provide a considerable PLA contribution to general economic construction<sup>54</sup> and to develop a more sophisticated and modern armed force. In that process, funding for the PLA has in some respects been better than may have appeared from the mere general budget figures. While the PLA has been given a reduced portion of the national budget, military modernisation has received help from other sources. Most obviously, the demobilisation of one million men led to considerable reductions in the PLA's running costs, but the savings from the 25% reduction in manpower costs were used to bolster other areas of military effort. Since 1983, there has been increased funding, for example, for military investment and for research and development.<sup>55</sup>

The PLA has also benefitted from Chinese arms sales to the Third World. It is estimated that in 1984-87 China earned US\$5.2 billion from such sales. Moreover, China has been able to obtain fairly sophisticated technology from the West. All this has sustained the move away from the Maoist version of "People's War" and drawing the enemy into China's vast spaces and human multitudes.<sup>56</sup> Certainly there are clear signs at every level of an upgrading of the technological levels of force components, and an improvement in capabilities. That includes human as well as physical capacities. The PLA has greatly strengthened the level of academic preparation for its officers. (China's National Defence University was opened in September 1986 after some 20 years during which formal instruction was neglected.<sup>57</sup>) But it inevitably includes various efforts at hi-technology developments, insofar as these can be made compatible with

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Continuity and Change, Issues and Studies, September 1988; June Teufel Dreyer, *The PLA: Demobilisation and Its Effects*, Issues and Studies, February 1988.

<sup>54</sup> See Shu-shin Wang, *The Economic Role of the Chinese Peoples Liberation Army*, in Richard H. Yang (ed.) *SCPS Yearbook on PLA Affairs 1987*, Kaohsiung, RoC, Sun Yat-sen Center for Policy Studies, 1988 pp. 135-152.

<sup>55</sup> See Tai Ming Cheung, *Disarmament and Development in China : The Relationship between National Defense and Economic Development*, *Asian Survey*, July 1988, p.771.

<sup>56</sup> See Paul H.B. Godwin, *Changing Concepts of Doctrine, Strategy and Operations in the Chinese People's Liberation Army 1983-1987*, *China Quarterly*, December 1987.

<sup>57</sup> See Review of China 1987, *Far Eastern Economic Review* 19.3.87, pp.56-108.

China's general budgetary problems, her restricted capacity for foreign purchases and the great range of needs for upgrading. China's space programme is active. She is developing a CZ-4 rocket scheduled to be capable of boosting a 2.5 tonne payload into orbit - with all the implications that will have for inter-continental delivery capabilities. Successful SLBM testing has occurred, multiple warhead technology testing has begun, as have cruise missile tests, a new supersonic bomber is said to be under development and. China has bought aircraft radar systems from Israel.<sup>58</sup> If the nuclear tests of warheads at Lop-Nor on 5.6.87 and again in 1988 are any guide, the development of a nuclear force has not slackened.<sup>59</sup>

It may be of special interest that these preparations include moves towards developing not just a blue water navy but longer-range power-projection capabilities. In 1986, naval air force long range bombers for the first time conducted exercises in the Pacific. In October 1987 part of the East China Sea fleet exercised into the disputed areas of the South China Sea. By the end of 1987 a new type of frigate with modern weapons entered into service. There has been armed action in the South China Sea. The Navy has said it wants more and better ASW equipment, shipboard early warning systems, mines and sea-skimming missiles.<sup>60</sup> There has even been debate about whether China should acquire the capability to construct aircraft carriers.<sup>61</sup> All of that is evidence of a belief that coastal defence will not be enough in a period when Soviet Pacific forces are developing further and Japanese capabilities are expanding. What will be needed, many Chinese evidently believe, is a capacity for longer-range defence and intervention. All that is quite apart from the need to be able to conduct limited operations on limited disputes about territory or territorial seas.<sup>62</sup>

The indications are clear that China is not, in the classic phrase, a "satisfied power." She has clear external claims: to the consolidation of Chinese rule

<sup>58</sup> *The Australian* 11.4.88, p.4.

<sup>59</sup> *The Economist* 13.6.87, p.38.

<sup>60</sup> *The Economist* 13.2.88, pp.50-51.

<sup>61</sup> See Hsin Wan Pao (Hong Kong), 30.11.88, FBIS/PRC 1.12.88., p.13.

<sup>62</sup> Xu Guangyu Pursuit of Equitable Three Dimensional Boundaries, Jiefangjun Bao 3.4.87., JPRS China: Political, Social and Military, 88-016, 29.3.88., pp.35-38.

in Tibet, to the restoration of Macao, of Hong Kong, of reunification with Taiwan.<sup>63</sup> She has claims in the South China Seas and residual claims elsewhere. Nor does China seem satisfied with the established order, either in the region or further afield. She will undoubtedly seek to further her national interests and objectives through diplomatic and economic pressures. (These may well include attempts to combine the economic power of China, Hong Kong and even Taiwan in a kind of "Greater China" economic thrust.<sup>64</sup>) Military power will not be her first line of the defence of her interests, although recent policies vis a vis Vietnam and the South China Seas must give her neighbours pause.

In any event, the major obstacles in the pursuit of these various national objectives continue to be, as they have been for so very long, with the domestic structure. And here it has to be borne in mind that some quite new problems are appearing on the horizon, at least some of which China shares, and may increasingly share, with other countries. It is not just that no one really knows just how the Chinese economy is performing because all the existing measurements are untrustworthy. It is not even just that the education system is - so far - inadequate to sustain China's general economic and technical ambitions, except in some specially favoured areas; or that in the absence of a much firmer industrial and technical base the capacity to develop high-grade armed forces to counter possible future external dangers and difficulties will be more limited than Beijing might like.

The fundamental difficulty is that in all advanced and advancing countries - and perhaps especially large ones, with big populations - the economic and technical future will in some respects be altogether different from the past.<sup>65</sup> Some of the new trends will diverge from, and even be subversive of, old forms of measurement, and even national authority. In contemporary conditions, the movement of information and even money across the globe can be instantaneous and in many respects uncontrollable

<sup>63</sup> of Harry Harding, *China and Northeast Asia; The political dimension*, New York, University Press of America (for the Asia Society), 1988.

<sup>64</sup> cf *Business Week* 19.9.88, pp. 18-21.

<sup>65</sup> Gelber, *New Patterns of Power Politics*, op.cit.

by public authorities. Cultural trends and influences cross national borders with ease. There are new and greater pressures to create and maintain where possible, comparative advantage, with the comparison by no means always in national terms. The locus of production for different goods can and does shift more quickly than ever before in response to expectations of such advantage. Participation in international bodies can impose new constraints on Governments, while the dynamics of the creation and maintenance of - and participation in - international and transnational elites, whether in sport or arms control, or trade arrangements, or environmental affairs, tend to qualify or change the way in which "national interest" is defined. It can even change the character and strength of the effective social loyalties and *modus operandi* of participating intellectuals and officials.

A genuinely modernising China cannot be immune from these trends. Closer links with international operations must have their inevitable effect. The effects of developing effective information and electronics technologies will be to link not just China, but Chinese individuals and groups much more closely to international methods of communication and, at one and the same time, strengthen non-Governmental groups and interests at home and trans-national ones but, either way, ones which are not under direct, or in some cases even indirect, Government surveillance or control. In addition, as the current experience of some of China's coastal provinces shows, economic and financial development, especially if it is associated with a closer relationship with the outside world, can erode not just the ability of national authorities to find out what is going on, but the ability to regulate money supplies, interest rates, inflation, investment or cultural trends. Flows of knowledge cannot be regulated; or, if they can, it is not clear that it can be effectively done by national authorities. It is not evident that as time goes by there will in every respect continue to be such a thing as a "Chinese" economy, any more than a "Swiss" or "US" or "Nigerian" economy. Problems of that kind will not so much erode all national authority as render its exercise more complex. Non-national technical sectors and economic activities will exist alongside national ones -

and essentially in a bargaining relationship with them - rather as the secondary and tertiary levels of economic activity have in recent times coexisted within national political entities.

Against that background the events of May-July 1989 in Beijing can be regarded as an alarmed reaction against the logic of China's own reform program, against modernity itself. The leadership failed, in the end, to understand - or at least to accept - the organic links which must exist in the modern world between economic and technical development and the needs of political liberalisation. China's need for economic restructuring and technical advance (the four modernisations) depends upon, and must in turn strengthen, demands for freedom of ideas in other and adjacent areas. Education, some freedom of thought, the encouragement of enterprise, cannot be promoted within the economic sphere but prohibited elsewhere.

Modernisation was therefore always likely to place question marks against the present structure of Government, even the position of the CCP itself. Although the Beijing students carefully refrained from openly challenging the Party, such a challenge was inherent in their movement. It was implicit in the spirit of the "Beijing Spring", its language, its demands for something called "democracy", in the symbolism of the occupation of Tienanmen Square, in the obstruction of Government business, in the initial repulsion of unarmed troops. It was also inherent in the students' demands which, precisely because they were so general and indistinct, were therefore in principle unlimited. Never before had the Government been so blatantly and pointedly defied, and in the heart of Beijing. It is, even in retrospect, not easy to see how this movement could have been countenanced, or its demands met, without undermining not just the authority of the Government but the very basis of the Party's claim to rule.

From the point of view of the older rulers, all this created horrendous dangers, not least of domestic disunity and therefore also of external weaknesses of just the kind from which they - and Mao - had rescued

China just forty years earlier.

Whether Deng and his colleagues have fully understood, let alone discounted, the costs of repression may be another matter. The Party and PLA are clearly divided on the crisis and its outcome.<sup>66</sup> There does not seem to be a legitimate process or institution for the transfer of power or even, in some respects, its exercise: all that remains is the struggle for power. The restoration of political stability may now have to await the succession to Deng, to whom there is now no anointed successor. With a divided military and a weak, if oppressive, centre, there may be some strengthening of regionalism in practice. Within the public, and especially in the cities, disaffection is unlikely to disappear merely because it has been driven underground. For all the power of Government propaganda, and the machinery for punishing dissidents, tens of millions of Chinese citizens will know what has happened. There are signs of a significant loss of faith in the Government and the CCP: something like a crisis of legitimate authority.

In some ways no less important, in repressing students and intellectuals the Government will have cowed into defensive silence precisely those classes, not just of intellectuals but of entrepreneurs, researchers, reformers, innovators, not to mention managers and people more familiar with the outside world, who are desperately needed to fulfil China's economic and other aims. Those thousands of students who have gone abroad and found broader horizons will be even more reluctant to return to China or may find frustration if they do. Economic contacts with the outside world will certainly suffer, at least in the short and medium term and until the central political uncertainties are resolved. It is not that foreign condemnation has been unanimous. As observed earlier, Mr. Gorbachev has quietly accommodated the events in Beijing. Japan has been visibly reluctant to

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<sup>66</sup> During the crisis, it seems that over 100 Chinese military leaders signed a letter to the Peoples Daily which was never published. The letter argued against the use of force in Tienanmen Square and said "The Peoples Liberation Army belongs to the people. It cannot confront the people, even more it cannot suppress the people and will never shoot the people." Quoted in Clair Hollingworth, Yang's political commissars back in authority, *Pacific Defence Reporter*, July 1989, pp.16-17.

take punitive steps. After all, Japanese companies have spent some US\$2 billions building factories in China over the last five years - making China one of Japan's largest manufacturing bases outside Japan - and Japanese businessmen, trying to look after their investments, have been among the first to return to Beijing.<sup>67</sup>

But nothing has happened that is likely to relieve the energy crisis which had caused some factories to shut down, or the shortages of raw materials and many products including steel. The upheaval itself must have caused great economic loss, and the sharp decline in tourism must be especially damaging insofar as it cuts off hard currency supplies. The future of Hong Kong, another major source of currencies and trade, is subject to new doubts. International groups and organisations seem likely to draw down their commitments. There are signs of a switching of investment and production from Hong Kong to Southeast Asia.<sup>68</sup> There has been sharp condemnation of China's repression by Western leaders. The World Bank has deferred consideration of US\$780 million in new loans to China. The West has suspended military sales and many high level contacts.<sup>69</sup> The reaction in Beijing is likely to include a stronger emphasis on self-reliant and inward looking policies by China's leaders, once again with predictably unfavourable results for the modernisation program. Altogether, China seems likely to have major economic and financial problems as funds dry up, productivity declines and, not least, as foreign debts fall due.<sup>70</sup> In 1991/92, for example, debts of HK\$12 billion will need to be dealt with.

None of that suggests that the Chinese economy will fail to grow and develop, even if it does so erratically and with occasional setbacks and even if structural reform is slow.<sup>71</sup> Or denies that education will improve over time, or that trade and financial dealings will at times be sophisticated or that

<sup>67</sup> *The Economist*, 1.7.89., p.21

<sup>68</sup> *Asian Wall Street Journal*, 11.7.89., pp.1, 20; *The Economist*, 24.6.89.

<sup>69</sup> *The Economist*, 1.7.89., p.19.

<sup>70</sup> *Business International*, quoted in *The Australian*, 30.6.89., p.70.

<sup>71</sup> Gregory C. Chow, 'Development of a More Market-Oriented Economy in China', *Science*, 16.1.87., pp.295-299.

foreign trading partners will derive benefits from their links with China, even if those benefits turn out to be in the long rather than the short term. But it does suggest that there will not be, as many have assumed, an even tenor to modernisation, let alone liberalisation within China. As Keidel has pointed out:

"If the forward momentum of reform were halted, it would be impossible for the different stages of partial reform in China's many economic sectors and dimensions to stagnate. Either stronger central planning and bureaucratic control ... would have to be reinstated, or reforms would have to resume."<sup>72</sup>

For the time being, the odds are clearly on more bureaucratic control, less initiative and dynamism, and all the difficulties which must flow, for both Chinese citizens and foreigners, from the present underlying political instabilities. Given the new international political and technical environment, the Chinese central Government has, at least for the time being, lost much ground and a great deal of public sympathy at least in the Western world. That will not stop some Chinese individuals and groups from doing well, even very well. Some regions will continue to prosper. But whether the Chinese State or its central Government, or its central economic management will do well, and by what criteria it may try to judge whether it does or not, may be another matter.

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<sup>72</sup> Keidel, *China's Economy in the Year 2,000*, op.cit.

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