China’s Growing Pains: A Review of 40 Years of Reform

Charles Parton

Now that Chinese President Xi Jinping has consolidated power within the Chinese Communist Party, the expectation is that he will turn his gaze to serious reform efforts needed to sustain the country’s rise. Changing an economic and social system described by Chinese leaders as ‘unsustainable’ without provoking instability – to be accomplished with the Party managing to stay in power and outrun problems of debt, demography, and water scarcity – will prove to be quite the challenge.

On 18 December 2018, Chinese President Xi Jinping gave a speech to commemorate 40 years since the Third Plenum of the 11th Central Committee, the political event which blessed the strategy of ‘reform and opening up’ and announced the start of an increasing role for the market vis-à-vis the state, with greater freedom for private operations and ownership. Xi’s speech was not short, but it could be summed up as follows: China has done well through its own efforts (a hit to recent claims made by US Vice President Mike Pence that ‘much of this success was driven by American investment in China’); this is all down to the Chinese Communist Party (CCP); the CCP must be in charge if progress is to continue; and China will emerge as a, if not the, superpower of the 21st Century. Shortly afterwards the Party held its annual Central Economic Work Conference (CEWC), a crucial meeting for deciding economic and reform policy.

Credit where credit is due. Over 40 years, China’s prosperity and power have been transformed. Society is more diverse and freer (despite recent setbacks) and culture and innovation have blossomed. Nevertheless, the process of reform needs rebooting. In 2007, former Premier Wen Jiabao declared the economic and social model to be ‘unstable, unbalanced, uncoordinated, and unsustainable’. In 2013, President Xi repeated the judgement (omitting ‘unstable’, presumably seen as too negative) and in 2017 a politburo member again used the phrase. The theory goes that a lack of progress in Xi’s first five years was necessary for him to consolidate power; thereafter he would move ahead quickly with reform. What commentators looked for in the 18 December speech and at the CEWC were moves to reverse out of the old cul-de-sac of ‘unbalanced, uncoordinated and unsustainable’ development.

What is Reform?

In his speech, Xi talked of over 1,600 reforms. They have come in four waves: the Third Plenum in 2013 launched economic and social reform; the Fourth Plenum in 2014 saw the arrival of reforms to establish ‘law based governance’; 2015 began reform in the People’s Liberation Army. The fourth area focuses on Party discipline and regulations, which Xi has tightened and expanded throughout his tenure, not least by revamping the Central Commission for Discipline Inspection and establishing a National Supervision Commission with broader powers, as well as by conducting a relentless war on corruption.

The National Development and Reform Commission (NDRC) is the face of reform (the ultimate authority is the Party’s Central Commission for Comprehensively Deepening Reform). One of its think tanks, the Institute of Economic System and Management, summarised economic reform under five headings:

- The government’s role, particularly streamlining authorisations and approvals;
- State owned enterprises (SOEs);
- Finance and tax, including debt/investment, changing the balance of revenue and expenditure falling to central and local governments (the latter currently receive 50% of revenue, but cover 80% of expenditure);
- Labour mobility, meaning reform of the hukou system (registration to a specific place for receiving services such as health, education and social security);
- The health system.

Underlying, and limiting, reform is the Party’s highest aim: staying in power. That in turn requires political and social stability. Unsurprisingly, the slogan of the 19th Party Congress was ‘progress amidst reform’. It also means that Xi’s aim is more about raising the efficiency of governance rather than changing its nature.

The catchphrase of the last Party Congress: ‘the market will have the/a (Chinese has no definite or indefinite article, making for ambiguity) decisive role in the allocation of resources’, in reality means only a greater role. Good Leninists do not relinquish control of the levers of economic power, because the market will create wealth outside its control, leading to demands for political power (‘no taxation without...
A busy shopping street in Wenzhou City, Zhejiang, China. Chinese President Xi Jinping wants a more innovative, hi-tech, service-oriented economy.

Courtesy of Fabien Lelard/Wikimedia
representation). Xi wants a more innovative, hi-tech, service-oriented economy, but with a strengthened Party cell present even in private enterprises. He wants social development, although education, culture, the media, and even entertainment must remain in line with the Party’s guidance. And he wants a more rules/law-based economy and society to engender trust and predictability, but the Party is specifically in charge of and above the law.

Above all, Xi wants the SOEs to be more efficient. Despite the much-touted solution of ‘mixed ownership’ – there is little economic incentive for non-state actors to invest – prioritising management of state assets, and personnel system changes, there is no inclination to remove from their perch of privilege the 96 most important and centrally controlled SOEs, nor many big local government-controlled SOEs – something which impedes the much more dynamic private sector. More efficient economic governance aims to help Xi tackle the ‘three crucial battles’, which he mentions in almost every speech as threatening stability and the Party’s monopoly on power: the debt crisis, now generally held to be over 300% of GDP; poverty alleviation/disparities between regions, cities and rural areas, and incomes; and the environment, where problems of pollution are increasingly bringing citizens onto the streets. Notably absent is any form of political reform, not even modest intra-Party changes.

How is Progress Going so Far?

Slow. To be fair, Xi’s original timetable of ‘basic’ completion by 2021 was never practicable. As early as 2014, a senior figure at an EU conference said that reform might take 15 years. Some changes take time. For example, judicial reform requires considerable recruitment, training and experience building of judges, who must be competent in many new areas, such as intellectual property, environmental, and financial law.

By early 2017, the Institute of Economic System and Management, was not impressed by progress (a major theme of a book it published in March 2017, entitled ‘Reform Obstruction Phenomenon’). The Asia Society Policy Institute/Rhodium Group autumn 2018 ‘dashboard’ of reform progress recorded mild progress in only eight out of the ten sectors it covers. Meanwhile ‘law-based governance’ has not got far: even Xi at a recent conference on the private sector highlighted the lack of protection for persons and property. That is basic to reform of law, itself basic to economic reform.

Why Has Progress Been Slow?

The reasons are many. It is true that Xi Jinping needed time to consolidate power, which in the CCP system means, first of all, controlling the military, the security services and the top levels of the Party. In all three areas, there were deeply entrenched and potentially hostile interests. Connected to this was the need to root out debilitating corruption (it also served as a weapon to bring down Xi’s political enemies, the prime example being ex-Politburo member Bo Xilai). That has not proved an easy task, as December’s politburo meeting made clear: ‘the anti-corruption fight remains grave and complex, and the strict governance over the Party remains a long and arduous task’.

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The scale of change is daunting and cannot be allowed to cause instability (‘progress through stability’, remember). SOE reform and levelling the playing field with the more productive private sector threatens to cause bankruptcies and unemployment from China’s 150,000 or more SOEs. And unemployment threatens stability.

Sequencing of reforms is very difficult, given the interconnectedness of reforms (for example, hukou reform impacts on land reform, which impacts on local government finances). Complexity has been mentioned already, leading to a lack of policy clarity. But it is accompanied by its ugly sister, contradiction: for example, increasing competition for SOEs leads to bankruptcies and unemployment, a threat to stability and thus to officials’ careers, since they are judged on its avoidance.

There is often a lack of resources at the local level to implement change. Then there are the famous vested interests, mainly the officials who have done very well in the past and are reluctant to see opportunities disappear. Furthermore, one effect of Xi’s relentless war on corruption and his continued campaigns for Party discipline has been to induce a fear of taking risks, of experimenting. Breaking the rules, with local officials’ encouragement, followed by high level endorsement was how many of China’s early reforms succeeded. The spirit of enterprise is quashed when a corruption or discipline charge stalks the land. Finally, many officials are likely to be suffering from reform fatigue.

Black Swans and Grey Rhinos

Xi rightly linked reform and stability in his 19th Party Congress slogan: reform is an innately unsettling process, but it cannot succeed if unexpected events (black swans) or predictable but suddenly charging problems (grey rhinos) cause a large measure of instability. The Party faces a big challenge. Reform started over ten years too late. Now, reducing debt is proving tough. If local governments reduce debt and services, if unproductive SOEs cease being funded by debt and go into liquidation, and if government ceases to fund investment projects (which may never produce a positive economic return) the consequences are likely to be social dissatisfaction, unemployment and instability.
Demographics are starting to bite: the labour force is shrinking and the population ageing. More worrying perhaps for stability is the fast-growing population of young males who will not find a female partner, a result of years of the One-Child Policy combined with cultural preferences for sons. Eventually, there may be as many as 40 million more males than females in the 20–40 year bracket. Sexually frustrated males are not a peaceful bunch. Many will come from the second generation of migrant workers, born in the cities, but with a rural hukou/registration, less well educated and at the front line of unemployment. This generation of over 100 million, who feel themselves to be second-class citizens, is now beginning to come of age. Finally, and perhaps most worryingly, there is a looming water crisis in the north of China. Water is essential for agriculture, power generation, industry and people’s lives, and around half of China’s agriculture, power, industry and population is located in 12 northern provinces where water scarcity is becoming an increasingly significant problem. This is likely to cause economic and social dislocation. And that is before the effects of climate change make their mark.

Can Economic Reform Succeed Without Political Reform?

Clearly, Xi believes that it can, because he has halted even the modest intra-Party political reforms which had been ongoing. When he talks of political reform, he means the strengthening of the CCP’s role in all spheres.

China is perhaps too complex, its population too large to be run by a centralised, top-down Party system. It is not possible to inspect and control every aspect of the economy and society, although increasingly it seems as though Xi is trying to do so. The system needs to be more self-regulating.

Yet Xi has deliberately cut off four allies useful to self-regulation:

- Free press and media. For example, in the fight against corruption, the press and internet once played a useful role. Now, investigative journalism or netizens who point out officials wearing watches beyond their salaries have been sacrificed to silence criticism or dissent.
- Civil society and NGOs. They can be an important source of ideas, innovation and pressure for improvement.
- An independent judiciary. The CCP has declared itself in charge of the law. This harms trust, including in business, where recourse to a reliable, unbiased legal system underpins confidence.
- Political accountability. It need not be Westminster or Washington-style, but to ensure that the people’s interests are put above the Party’s, local officials need to know that if they are not accountable to local people, they can be voted out of office.

What Does the Future Hold?

2021 marks the end of Xi’s second term as Party General Secretary, as well as the 100th anniversary of the CCP’s founding and the achievement of ‘a moderately prosperous society’. Back in 2013, Xi declared it as the year for completion of reform.

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Even a later deadline would require a considerable acceleration of reform, but the trends noted here do not suggest such. So, what might the future trends be? The assumption must be that, despite rising opposition or unhappiness, Xi will remain in power (authoritarian rulers usually look ironclad until the moment they fall). That being so, unless Xi radically changes his approach to governance and the impact he has on lower-level officials, it is likely that the incentives for them to innovate, experiment, take risks and implement change will be lacking. The CCP is likely to continue to play a strong role; corruption and discipline wars will not end; society must swallow more ideology and supervision as Xi tries to create ‘New China Man’, a politicised society more in line with his view of socialist values; and above all the Party may be able to control the people even more than it currently does, as big data, artificial intelligence, recognition technology and social control systems combine into a more formidable weapon for the Party to limit dissent or unorthodoxy.

To those sitting outside China, all of this matters. Those who prophesy that China will be the world superpower by mid-century presume that its current economic model and growth is sustainable. That may not be so, unless reform is both more rapid and more far-reaching. Optimists will remind us that the Party has surprised us before.

The stakes are high, because a China which slips up badly would have a large negative impact on the world. In the worst case, as Chinese leaders sometimes hint at, imagine if 1% of Chinese left China as economic migrants. The world would cope, although with great difficulty, in absorbing 14 million immigrants. Or a regime faced with instability might try to distract its people with bombastic nationalism (taking Taiwan by force?). At the very least, if reform fails, the global economy would tank.

So, as 2019 dawns, the world should hope that Xi’s reforms are moderately successful, but avoid giving rise to hubris. Pandas may look cuddly, but big ones can be dangerous.

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