

The Historical Orientation of China's Reform

By He Qinglian¹*

Modern China Studies

No. 1, 1999 (Volume 64)

Since 1978, China's economic reforms have proceeded under difficult circumstances of all sorts. At present, it is experiencing yet another painful period known as the "reduction of marginal effect." On the surface, the main reason for this "reduction of marginal effect" is that a variety of economic problems are hampering further reform efforts. If we choose to go below the surface, we are likely to find that these economic problems are rooted in non-economic areas, and consequently, it is impossible to remove the obstacles with pure and simple economic reform. Based on this reality, the author believes that the following issues will have to be addressed in order for China's reforms move forward. First, is it necessary to review and examine critically reform efforts to date—and to review and examine free of ideological constraints? Second, is it wise and feasible for a country to limit its reform efforts to the economic area? Third, shall social justice be taken into consideration while formulating reform policies and is it necessary to pass value judgment on the results of reform? This article will first answer these three questions and then take a step further to analyze the historical choices with which China's reform is faced today.

1. Reform Must Be Reviewed and Examined with A Critical Eye

Every major reform effort in human history has encountered various problems and side effects, which, however, should not be justified simply in the name of reform. To overcome these problems and side effects in a timely fashion, it is necessary to review and examine critically the reform efforts. Moreover, any reform turns the old social order upside down and redistributes social benefits, and therefore is bound to meet resistance and opposition from various directions. We should not purposefully avoid a critical review and examination of reforms because of such resistance and opposition.

*¹*Ms. HE Qinglian is a visiting scholar at the University of Chicago. She left China unannounced in June 2001 in the face of widespread, government-sanctioned harassment of scholars. She is the author of two books: We Are Still Watching the Stars Above (2001) and China's Pitfalls (1998). Both document the dark side of China's economic reforms and address issues such as corruption, inequalities and the breakdown of the social fabric previously weaved by China's state-directed economy. Ms. He holds a master's degree in economics, and most recently worked in China as a reporter for the Shenzhen Legal News. This article is reprinted with permission.*

When reforms just got under way in the early 1980s, there was a rather strong ideological current running against it. Meanwhile, the supporters of reform had just walked out of the shadow of the “great” Cultural Revolution and were very apprehensive of a possible backlash from the "left" that would reverse the course of China's reform. As a result, they were very sensitive to any voice that advocated such reversal. At that time, based on their attitude toward the old ideology on one hand and the general direction of reform on the other, people were often divided into two major camps: the reformers and the anti-reformers.

With twenty years of reform behind us today, the general direction of reform is unlikely to be reversed. Meanwhile, reform has brought with it various problems. Under such circumstances, we should not regard criticisms directed toward any of the problems as "opposing reform," nor should we try to whitewash efforts aimed at covering up bad practice and categorize such efforts as "supporting reform." To criticize reform is not necessarily opposing reform--a more demanding attitude may very well be an expression of deeper love. If today we still regard any criticism of reform as opposing reform, we are erring on the side of oversimplification. Moreover, support of the reform should not be limited to slogans; it is necessary to conduct analyses to find out what supporters really support. If we cannot go beyond the generalization of "the leftists," "the rightists," "the reformers" and "the conservatives," we are unlikely to attain any depth in our critical thinking of reform.

With various problems emerging from the reform process, we should allow people with insights to take advantage of different means (particularly the news media) to engage in in-depth discussions. This way, we would be able to identify the root causes of our problems and take well-targeted measures. If we forgo a critical review and examination of reform, adopting an "ostrich strategy" and avoiding discussion of the problems brought about by reform, we will not be able to solve the problems and will miss opportunities to address digressions.

This author believes that critical review and examination of reform should be conducted in four dimensions: (1) to critique the goal of reform; (2) to critique the process of reform; (3) to critique the strategies of reform; and (4) to critique the means of reform.

During the course of China's reform, the previous egalitarian society was transformed into an unequal society characterized by an unwarranted gap between the rich and the poor within a period of a little more than a decade. Moreover, during reform, while some people became rich by exercising their privilege, others were forced to bear the heavy burden of the downside of reform. Such a situation has given rise to undesirable reactions and social conflicts that we will not be able

to avoid and will find difficult to resolve in the future. Such results were not the original goal of the reform. In implementing reform, China has a manifested objective of raising the living standards of its people, but has never openly endorsed social inequality; on the contrary, like many developing countries, China has adopted policies in favor of social equality. As reform went on, however, the results were pointing in the opposite direction _ a very small privileged class has become increasingly rich.

The digression from equality has occurred not entirely as a result of the goals pursued by reform, but also as a result of the means employed by reform in the past twenty years. In the transition from a centrally-planned economy to a market-oriented economy, the approach to dealing with two remnants of the centrally-planned economy _ the national resources under highly centralized control and the immense assets under state ownership _ will have a direct bearing on the distribution of societal wealth. There is one major difference between China's current "simulated market economy" and a real market economy: the distribution of resources is not accomplished by "the invisible hand"; instead, the government plays the role of the market in distributing the resources. As a result, when the hand of administrative power, which allegedly represents state interests, handles resource distribution, the process is grossly distorted by the people who enjoy that monopoly of power and becomes a hand that works in the exclusive interests of the privileged class. Consequently, corruption is rampant and rent-seeking knows no boundaries. The state-owned assets as well as the resources that used to be under the control of local governments at various levels become the "prey" of rent-seeking interest groups. Ideologically, China is strongly against the system of private ownership, but in reality, it has allowed a small group within the circles of power to use their influence and complete a primitive accumulation of capital.

Accompanying this phenomenon of power-generated wealth is a society-wide pursuit of money and the resulting "money syndrome," an issue that has a bearing on China's reform strategies. Must China's reform be guided by economic development? After all, a nation or a society is not a gigantic corporation, and the head of a state is not a chairman of the board of directors. Healthy development of a nation or a society cannot afford to focus exclusively on money; instead, there has to be certain less materialistic ideals to provide guidance. If a nation sets as its ultimate goal the pursuit of economic development and enrichment of individuals, and defines success by money, its people will compete against one another in a zealous pursuit of money, totally disregarding other social objectives. In a society, if half of the population goes after money and the other half remains committed to healthy social development, this society cannot be said as morbid; but if the overwhelming majority in a society take wealth accumulation as their ultimate goal of life and suffer from a "money syndrome," there is no way to deny that this is indeed a morbid society.

The characteristics of today's Chinese society _ the mobilization of society with money and the social practice of exchanging power for money _ have not been the result of misguidance by a couple of individuals; rather, they originated from within the system. On the surface, there exist many laws and regulations forbidding transactions between power and money, but they have not proven effective. This phenomenon is related to an issue that the author has discussed on many occasions, namely, the fundamental difference in the rules of social activity between developing countries and developed countries. In a developed country, formulating a law or a regulation is a long and arduous process, and the final version has to go through many rounds of debate; however, once it is finalized, it will be implemented faithfully. In all developing countries, on the other hand, it is not at all difficult to formulate a law or a regulation, but most likely it will be grossly distorted in the process of implementation. In the past two years, China has produced on average a law or regulation every 18 days; nevertheless, the whole society is faced with a situation in which existing laws are not complied with and those who are in charge of enforcing the laws are abusers themselves. As a result, the central government had to reduce the scope of its anti-corruption campaign to focus exclusively on the corruption in the law enforcement agencies and the military. In a highly politicized society, the rules that govern social activities are not laws and regulations, but the power structure and the manner in which power is exercised. When power is unchecked, policies and regulations are likely to be distorted.

2. Will "Economic Reform" Alone Lead to Success?

Today, China is faced with an issue that perplexes scholars: can social progress be achieved by "economic reform" alone?

In the past twenty years, some economists studying economic issues in developing countries have started to undertake systematic research on the interactions between economic forces and social system and polity. In general, social development is a process of expansion of human choices; so is economic growth. There are three channels for economic growth: (1) to expand the base of resources and accumulate capital; (2) to improve qualities of individual human beings through education, namely, to improve human capital; and (3) to improve the structure of the social system. The system is important to normal development and progress of the human society, because it impacts the availability of information and resources, provides motivation to individual members of the society, and determines the basic rules of social transactions. Successful innovation of the system is likely to exert a positive influence on the choices of individuals and the society, and to contribute to social development by providing more effective means to organize economic activities. This will

normally lead to an adjustment of the economic structure and the social basics. In fact, like all other developing countries, China is faced with the issue of system innovation, and a related issue of how to take advantage of such innovations to effectively expand its capital base and improve its human resources.

Following the above logic, we should not limit ourselves to economics in exploring the path of modernization of developing countries; moreover, we should not indiscriminately apply the concepts and models of modern economics, because modern economics has been fostered in developed countries and its concepts, models are based on the real systems of developed countries. In developed countries, it is possible to arrive at reasonable conclusions by conducting analyses using pure "economic language" (general concepts like employment and unemployment rate, savings, investment, as well as demand, supply, and price; assuming the normal functioning of market mechanisms). However, if such methods, concepts, and models are applied to developing countries without modification, the results of analyses are likely to be seriously distorted and, even at their best, will be inconsistent with the specific situation of the country studied.

In developed countries, rational concepts and behavior have long been fostered in the relatively mature market economy and the democratic political system. Such a system is capable of effectively propelling sustained economic development and making quick but stable adjustments in the economic and social structure. In developing countries, on the other hand, market mechanisms are not allowed to function freely, and in some cases are non-existent. Therefore, the basic system and behavioral assumptions underlying modern economics may not be valid. If the economic theories, assumptions and concepts of developed countries are employed without modification to explain the economic problems in the developing countries, the study will be detached from the system and behavioral patterns of the developing countries. Economics is a science based on experience. If the object of the study is developing countries whose system and concepts are different from developed countries, the theories used in the study will have to be modified accordingly.

China is an Asian country and therefore an examination of the history and current situation in other Asian societies will help us understand our own problems. All Asian countries have one common characteristic, namely, there exists gross injustice as well as profound disparities across the social strata. Before the 19th century, such disparities were often associated with family background, as people were born with different social statuses. The invasion by Western imperialists and colonialists gave rise to a new social class _ the middle class consisting of small business owners and the new nobility made up of the well educated, whose emergence complicated the traditional

class formation marked by disparities and social injustice.

In the 20th century, the educated elite within the ruling class played an important role in Asia's historical development. During the transition of power resulting from violent social revolutions, a small number of such elite became advocates and organizers while ordinary people had neither the intention nor the ability to participate in modern political maneuvers. After the revolution, the characteristic of inequality from traditional society remained and the concept of social status was still viable. In these Asian countries, the majority of the people continued to regard themselves as "subjects" as in the traditional society instead of "citizens" in a modern society. Top-down political modernization and democratic procedures (such as elections) often ended up in practice as tools used by the ruling class to lend themselves legitimacy.

Having conducted in-depth research on the election systems of Asian countries, some Western researchers pointed out: public elections, which is regarded as an indispensable part of political democracy, often becomes in practice a manipulated process in which the ruling elite solicit voter support by means of bribery. In fact, ordinary people constitute no more than an audience for the election "show." In some countries, voters even look at elections as opportunities to make small financial gains by selling their votes. As a result, the voters do not make honest and independent decisions in elections and understandably, such elections are unlikely to lead to significant social or political changes. In many Asian countries, ordinary people, accustomed to the inequality of opportunities and the deep-rooted hierarchical social structure, often regard government directives as behavioral guidance. Even if the political elite possessed much greater "liberty" or privileges than the populace, most people tend to take it as the way it should be simply out of habit. In general, the state has tight control over-or forbids activities by-civic groups which make it difficult to form a society made up by relatively independent citizens. Establishment of any type of organizations (including academic organizations) must be reviewed and approved by relevant government agencies. Moreover, the government frequently forbids participation by any social group in political activities.

Rulers in many Asian countries always stress how different their respective countries are so as to rule out the modern democratic political system under the pretext that freedom, democracy, and human rights are peculiar products of the Western civilization and historical evolution. Meanwhile, they focus exclusively on material civilization whose main contents are economic modernization and industrialization, stating that social stability and preservation of the existing power structure should be given supremacy over everything else. This is the main motif of the so-called "Asian values." Admittedly, under such a political and social arrangement, economic modernization and

industrialization will be beneficial to economic development, but at the same time they will also lead to centralization of power and greater social inequality. A substantial portion of the wealth generated by economic development is pocketed by a small number of privileged people due to power brokering. In many Asian countries, the head of state becomes increasingly rich. On the one hand, there are numerous corrupt government officials who make small and medium-sized fortunes by extortion and trading power for money; on the other hand, ordinary people are excluded from the wealth distribution process. With limited resources and social inequality, modernization and industrialization have failed to resolve problems passed down from old societies. Even worse, hunger, poverty, violence and misery of the lower classes have been accentuated. Overpopulation, antagonism and conflict arising from the dichotomy of city and country, pervasive corruption inherent in political and social inequality, high cost of technology transfer and development, emergence of technocrats and excessive expansion of government agencies are all factors that keep these countries trapped in an "ill-fated setting," preventing them from further development.

There are similarities between China's problems and those of the above-described Asian countries. Therefore, if China chooses to ignore political implications of economic activities and focus exclusively on the resolution of economic problems, it would be like weaving the emperor's clothes. We would be deluding ourselves by not finding feasible solutions for existing economic problems. In all developing countries, including China, there have been "problems," but there have never been any "pure economic problems." Such "problems" faced by developing countries are highly complex. A host of non-economic problems, which modern economics does not seek to address, take on great importance in developing countries. The methods, theories, and models based on Western societies have ruled out non-economic factors and, once employed to analyze the "problems" of developing countries, will lead to a gross distortion of realities.

In China, economic reform has been given political legitimacy by five documents adopted at "the third plenary session" [of the Central Committee of the CPC]. The general direction of reform has been reaffirmed by the "15th Party Congress [of the Central Committee of the CPC]." Therefore, from the very beginning, economic reform has been the result of political actions instead of economic actions. During the reform process, distribution of resources affects each and every nerve end of the nation and the society and has been pre-determined based on the power structure long before any market mechanism is given opportunities to function. From this perspective, China's economic reform is definitely not market-oriented economic behavior; on the contrary, it is the result of government behavior. Evidently, to study China's economic problems, one must examine the current system in which economic forces are played out. The results generated by studies employed without modification of the methods and theories of modern economics can only be an

irony to the Chinese people (particularly the disadvantaged).

China's reform model has been referred to as "the path to modernization with Chinese characteristics." However, if we look at the history of development of all the countries in the world, can we find any country that has successfully reached the end of "the path to modernization" solely through "economic reform?" The path to modernization is a process of system innovation which has three dimensions: (1) innovation of ideology; (2) change of property ownership; and (3) reform of government behavior. The three dimensions are closely interrelated and lack of innovation in any dimension will lead to a loss of balance in social and economic development.

All the underlying problems revealed in China's economic reform have their roots in non-economic areas. In recent years, corruption has been running rampant, which, on the one hand, indicates serious flaws in the current system and on the other hand, sends a warning signal that fundamental changes are necessary in the distribution of resources, means of social mobilization and access to information. Otherwise, efficiency and productivity will be on the decline and an increasingly greater share of benefits from reform will be claimed by various rent-seekers instead of entrepreneurs. In the final analysis, this type of "reform," which focuses on resolution of economic problems to the exclusion of any political content, is "half-baked reform." It may seem effective during a certain period of time, but in the long run the accumulated problems will manifest themselves in different forms and demand a more costly remedy from society. The financial crises that have plagued Latin American and Southeastern Asian countries were in fact the results of such a loss of balance. It has been 20 years since China started its top-down economic reform, but the change of property ownership is only halfway complete, because in the other two dimensions-innovation of ideology and reform of government behavior-there is still a long way to go. For instance, at present private ownership is still not protected by the Constitution, whose amendment on the basis of a market economy remains a major issue.

In general, government leaders in developing countries are willing to adopt recommendations on economic reform, but are much less inclined to listen to opinions on reforming the political system. Moreover, system weaknesses are often attributed to poor qualifications of individual civil servants. In China, there is a similar practice that involves upgrading secondary issues to primary issues and thus attempting to resolve primary issues by tackling secondary issues. For instance, since the "Party 15th Congress," some people have held that social development targets can be achieved through expansion of the private sector (privatization). Many local government officials, misled by such a strategy, have fallen into a trap, thinking that state-owned enterprises (SOEs) will be able to improve its efficiency automatically once they are privatized. They neglected one

important fact: restructuring of ownership interests (also known as "ownership reform") only serves to change the incentives within the SOEs, but does not ensure its survival and growth. In other words, given the increasingly intense conflicts characterizing China's economic structure, restructuring in the form of ownership change and separation of ownership and management provides only basic conditions for survival, while the crux of the matter lies in transforming the social system in which business enterprises operate and encouraging them to change their operating mechanisms.

In fact, since 1998, operating loss and bankruptcy have no longer been limited to SOEs. The private sector, a natural product of a market economy, has also posted significant losses. The slowdown in the private sector will deal a heavy blow to the economy and its negative effect is likely to exceed the fluctuations resulted from SOE reform. Based on this fact, it can be concluded that since the success of private enterprises in Western countries has been facilitated by an accommodating system, the lack of such a system in China will continue to hamper the growth of private enterprises. Some economists have discovered that the core issue in China's economy is no longer SOE reform, but a transformation of the whole economic structure, whose success in turn depends on changes in the system.

3. Reform Must Give Due Regard to Social Justice

In the process of reform, another issue that needs to be addressed is social justice, which has been oversimplified as a necessary "cost of reform." All reforms (including revolutions) in human history have basically been aimed at the redistribution of interests, including political power, social prestige, control over cultural norms and wealth. The principles for such redistribution must be fair and based on the consent of the majority of the population. Only when the majority gives its consent can the principles have moral legitimacy. Before reform, China achieved equal distribution by sacrificing equal opportunities. However, the majority of the population accepted it as reasonable. The content of concepts like "fairness" and "justice" has evolved with time. After reform began in China, notions of justice based on a society of small farmers have been overturned. As a result, it is necessary to give new meaning to concepts that are fundamental to the formation a common understanding of fairness and justice in a society undergoing reform.

In discussing the issue of social justice, we must first determine whether fairness and justice are confined by national boundaries. Ever since the Age of Enlightenment, justice, fairness, liberty and human rights have been regarded as the basic principles of human society and unambiguously recognized as such internationally. This is particularly true of the principle of social justice, since it

is related to distribution of societal wealth. Social justice consists of three elements: (1) elementary justice (or equal opportunities), (2) procedural justice (involving fairness of competition), and (3) consequential justice. In Western countries where market economies are mature, the first element of social justice _ equal opportunities _ is no longer a challenge; rather, the challenge that these countries face is a lack of consequential justice. *A Theory of Justice*, a well-known work by John Rawls first published in 1971, reflected the need to modify the principles of distribution in the United States. According to him, justice consists of two principles: the first one was recognized by the Declaration of Independence while the second one, the principle of disparity, calls for the implementation of the first principle by means of compensation and is intended for the protection of the disadvantaged. In a sense, the process of modernization throughout the world has been characterized by the recognition of the modern norms of Western civilization. Therefore, the earliest principles of social justice established in Western societies are to some extent appropriate to humankind in general. Whether an Asian country or a Western country, once the process of modernization has begun, it is unlikely to question the validity of such principles.

However, because of differences in polity, culture, history and other aspects, countries may be faced with different issues in terms of social justice. As a result, the specific content of social justice varies from country to country. Thinkers and social scientists must effectively explain and respond to the realities in their particular country and should not directly copy theories developed by scholars of another country.

During China's reform process, social injustice has manifested itself in the form of unequal results, but the reason for this is the lack of elementary and procedural justice. For instance, a bank employee in charge of loan approval or a civil servant with the authority to distribute land resources tends to be far ahead of ordinary people at the start of the race towards wealth. Those who enjoy the power to allocate scarce resources and those who are well connected are obviously much better equipped than the man in the street to make big fortunes. In the big-bubble areas of stock market, futures, and real estate, numerous transactions are conducted in "black boxes" between those who enjoy power and those who have money. For a long time, a two-tiered pricing system was applied to certain scarce goods and resources. As a result, many people realized that, in comparison with the exploration of new markets, development of new products and increase in enterprise efficiency, it was much easier to seek "rent" by pocketing the difference between the state-planned prices and market prices. Moreover, the "profit" was much greater. Consequently, more and more business enterprises became involved in developing contacts and in speculation instead of making efforts to improve performance.

As bribery becomes the norm of our times, interest-sharing groups have taken shape in Chinese society, and the transaction cost (cost of bribery) has been on the rise. "Tendering," "bidding" and other superficial forms of competition have become "decorations" of the power-money trade and there is no transparency to speak of in economic activities. Under such circumstances, it is impossible that any justice will result from the grand competition of "gold mining." The redistribution of wealth will undoubtedly lead to a situation where some people take advantage of the opportunities to strike it rich by trading power for money, while ordinary people bear the "cost of reform." Activities of the privileged hamper normal economic development, reduce efficiency, expand losses of SOEs, distort the economic structure and ultimately cause mass unemployment.

Since 1980s, China has been engaged in a sustained debate over "fairness" and "efficiency." The issues underlying this debate are completely different from those about the same concepts in the West. In developed countries, the first principle of justice (elementary justice) is largely in existence, and "fairness" as opposed to "efficiency" is limited to consequential justice. In China, however, neither elementary justice nor procedural justice is in place. In exaggerating the conflict between "fairness" and "efficiency," some theoreticians have totally disregarded the fact that the issue of social justice must be addressed on the basis of specific situations in each country. In today's China, priority should be given to elementary justice so that power will exit the economic arena. Under the current system in China, there is no trade off between "fairness" and "efficiency." The social injustice in the current system has not been caused by an over-emphasis on "fairness" at the expense of "efficiency;" on the contrary, it has originated from the interference of power in what could have been free competition. As a result, social justice is undermined while efficiency suffers as well. Therefore, to China, the correct and only choice is giving priority to justice. Once justice is established, efficiency will follow.

As indicated by the problems which developing countries normally face and which China's reform have revealed, social injustice places direct constraints on economic development. During the 19th century and early 20th century, countries like the United Kingdom and the United States sacrificed social justice for efficiency, which placed a heavy burden on several generations of ordinary people, who suffered from loss of dignity, reduction of living standards, oppression by the moneyed class, uncertainty, social upheaval, and so on. Drawing a lesson from the experience of developed countries, today's people in developing countries have a much better understanding as to what they want. They know well that their poverty has been the result of certain social system and structure, not predetermined by fate. They also know that social justice is achievable. After a majority of the people become aware of their right to justice, unfair practices will weaken social coherence and undermine the political system which preserves social stability if the ruling class refuses to make

any improvement. For the same reason, some developing countries, despite many years of economic growth, have experienced sustained social upheavals and are yet to achieve the minimum goal of political stability. In the end, the political elite themselves, such as Marcos of the Philippines and Suharto of Indonesia, have fallen victim to such unbalanced development. As has been indicated by continued social unrest in some Asian countries, the social base of "Asian values" has been shaken. We are probably entering a historical period in which "Asian values" will be modified and changes have to be made to incorporate political and social reform in the modernization process. During the next phase of China's reform, attention must be paid to the distribution system.

4. China's "Half-Baked Reforms" Have Created an "Economic Fault Line"

Having ignored social and political reform, China's "pure" economic reform has created gigantic "economic fault lines," which have two dimensions: the gap between financial economy and material economy, and the gap between material production and consumption. The first gap has originated from the weaknesses of the financial system. In past studies, this author has pointed out that the financial risks that China faces are a combination of risk factor witnessed in several different countries, such as South Korea, Mexico, and Thailand. These factors may cause, at any time, a break in the chain of domestic payment in China's financial system. Once a crisis breaks out, it will be more difficult to handle than the Southeastern Asian financial crisis. [1]

The emphasis of the current study is on the second gap, namely, the gap between material production and consumption. In recent years, one of the major problems plaguing China's economic development is the lack of effective demands at the marketplace, which, apart from deterioration of the financial conditions, can be attributed to the huge imbalance between the material economy and financial activities. And such an imbalance has been gradually created by employment of an irrational and distorted economic structure for the past 20 years.

The irrationality of China's economic structure is primarily manifested in its industry and product structure with the following characteristics: (1) the product structure is outdated and imbalanced, (2) the industry structure is based on small, scattered enterprises, (3) various regulatory agencies and enterprises under their respective supervision form separate systems, which lead to redundancy and compartmentalization, and (4) economic structures across different regions lack diversification—the same is true of emerging industries (motorcycles, automobiles, home appliances, etc.). The irrationality of industry and product structure has resulted in excessive capacity and high inventory. In industries like home appliances and machine processing, factories

run with only 50% capacity. By the end of 1997, the nation-wide inventory total had reached a staggering 3,000 billion *yuan* (Renminbi), of which 1,300 billion *yuan* was classified as excessive buildup.

Excessive capacity and high inventory are the direct result of on-going intervention in resource distribution by administrative power. The intense interest in resource distribution on the part of government officials at various levels can be traced to incentives in two areas: (1) to improve personal performance record, and (2) to maximize personal gains. As long as these two incentives remain intact and that China's system allows or even encourages intervention in resource distribution by administrative power, the economic structure will not be able to return to rationality. It is true that China has been advocating enterprise reform and independent operation and has started to implement new rules governing enterprise operation, but in order for such rules to be effective, the market must first see corresponding changes, which at present are nowhere in sight. China's market has a number of unique features. The product market is relatively well-established while the capital market and market for other important elements of production have experienced irregular development; the market for stocks and futures is basically a "government policy market," which is marked with rampant speculation and fails to transform economic information into effective signals. It does not provide businesses with useful services, either. Given such a situation, businesses can only base their decisions on incomplete and distorted market signals and understandably, such decisions frequently end up on the wrong side.

The second feature of the irrational economic structure is that development of tech-intensive products and industries has lagged behind. As a result, China's products are facing increasingly tougher challenges at the international market. Over the years, China has relied on goods produced in low-tech factories to boost its export, and even today, low-end products and products from labor-intensive industries count for over 70% of the total export value. Such an export structure will not be able to pass the test of fluctuations in demand at the international market--to a large extent, the recent crisis that struck Southeastern Asian countries were caused by export growth based on this model. Thanks to its government-controlled exchange rate, China managed to dodge the blow, but witnessed a dramatic decrease in its export growth rate (approaching zero). The effectiveness of export in driving overall economic growth was greatly reduced.

Another feature of the irrational economic structure is that there exists a huge gap between supply and demand. Because demand is slack and there are few hot products to stimulate consumption, there is a big surplus of goods and products. In the past two years, the government has tried all sorts of ways to stimulate domestic consumption, but to no avail. This gap between supply and

demand hampers economic growth and will remain a "bottleneck" in future development. The slack demand is a direct result of unfair distribution. Although the nation-wide savings total has passed the threshold of 5,000 billion *yuan*, it has yet to generate effective consumption, as 40% of the savings total is concentrated in the hands of 10% of the population while people at the medium income level, who make up the majority of the total population, find it difficult to raise their consumption level. Moreover, the income of the farmers (approx. 900 million) remains low. Rural population makes up 75% of the nation's total, but its consumption accounts for less than 40% of the nation's total. It is impossible to invigorate consumption without participation from the rural areas. In addition, medium-level and low-end goods as well as shoddy and unwanted goods make up a large portion of the market. Even in rural areas where people have a preference for bargains, such goods are hard to sell. Compared with the relative surplus of goods in developed countries where high consumption is accompanied with high income, China's lack of demand and surplus of goods are different in nature. Any accurate diagnosis of China's current economic situation must be based on this premise.

In any modern economic system, there has to be a balance between physical assets and financial assets. There are several reasons for this. First, in the final analysis, the reliability and stability of the financial system is based on the prerequisite that money can be converted into physical assets. Once this prerequisite is no longer met, the whole financial structure can collapse at any moment. Second, financial speculation, which sits at the top of the financial pyramid, can generate paper wealth, whose real value and further growth depend on constant absorption of resources from the lower levels of the pyramid. As indicated by La Roche's empirical studies, the United States, Germany, Japan, and other capitalist countries owe their success of economic development to past government practices that insisted on the constraint of the financial system by the material economy; in other words, the government did not believe that financial capital was omnipotent. Later on, however, Japan developed a myth around financial capital and allowed blind expansion and rampant speculation, only to find its economy trapped in a long and painful recession.

La Roche once pointedly stated: in China "the people are so naive that they believe magnificent office buildings and hotels represent economic growth, but actually most of them were a waste of valuable resources that could have been used for modernization of production infrastructure. This over-building has been closely related to the real estate markets both inside and outside of China as well as the increase of virtual capital in the financial markets. In the short run, such an imbalance in growth between financial assets and physical assets is likely to be covered up by ostensible prosperity, but when the "paper profits" of the financial sector exceeds the growth of material production, financial crises will find expression in a sudden burst of bubbles like the 'Chilean

miracle' or the 'Mexican miracle'."

As indicated by the above-mentioned signals, China is indeed on the verge of a profound economic crisis. Had a similar situation existed in other countries, an overall economic crisis would have already been caused by a financial crisis. At present, however, the crisis is still latent in China due to the following conditions: (1) the Chinese government maintains almost 100% control over the banks, (2) "the Chinese people are relatively obedient and seldom question the trust they place in the government," and (3) the financial sector has not been opened to the outside world, which prevents a free flow of capital. Factors (1) and (3) will gradually disappear after China is admitted to WTO while (2) is regarded by some as a solid "breakwater" against possible financial crises. Admittedly, the trust placed by the Chinese people in their government has indeed contributed significantly to the current "stability," but it would be preposterous to base social stability on the premise that "the people are obedient and will not make trouble" or even use such a premise for policy formulation. The reason is simple. No matter how obedient people may be, in the long run they will not tolerate social injustice, which totally disregards moral standards in power, privilege, and wealth allocation. Faced with the gigantic fault line between physical assets and financial assets, China must incorporate into its agenda alteration of reform strategies in addition to taking short-term measures to prevent crises.

5. The Historical Choice of China's Reform

China's modernization process started over 100 years ago, but up to now the achievement is limited. Faced with this reality, we cannot but conduct an in-depth analysis of the historical development.

The core of modernization is undoubtedly industrialization. From a historical perspective, industrialization around the world can be divided into four phases. During the first phase, the United Kingdom achieved industrialization through accumulation of industrial capital. During the second phase, Germany and the United States utilized financial capital to propel industrialization. During the third phase, Japan and the former Soviet Union completed industrialization under the direct management of the state. During the fourth phase, which began after World War II, a number of countries and areas became industrialized (NICs). NICs made full use of the international division of labor with the United States and Japan at the center, gaining access to technology,

equipment, market as well as capital. Meanwhile, they also learned from past experience of the developed countries in system construction, thus accomplishing miraculous economic growth.

The history of China's industrialization is very long. The Westernization Movement beginning in 1870s can be regarded as an initial effort towards industrialization. In the 1950s, an industrialization process based on the Soviet model (the third phase) _ namely giving priority to establishment of heavy industries _ was launched. By early 1980s, China once again participated in industrialization (the fourth phase) as a latecomer. Out of the four phases of industrialization, three did not see China until the last moment. Understandably, the modernized system of national economy remains weak. In his "Rejuvenation of China _ A Contingency Plan for the Next 100 Years," La Roche compared the differences in physical asset indicators between China and Germany a century before and warned that China's economy "is wrapped up in a thin 'shell' of relatively modern science and industry while its gigantic base is pre-industrialization and outdated." Indeed, China's primary industry is still built on the pre-industrialization base and even the most advanced portion of its secondary industry is no more than a "modular assembly."

China should examine seriously not only its industrialization path, but modernization processes in other areas as well. What deserves particular attention is: the 20th century is almost over, but the major problems that troubled China at the beginning of the century _ overpopulation, education, shrinking agriculture (reduction of marginal effect), social injustice, government corruption, etc. _ have become all the more complex and more difficult to tackle. All the problems originate from China's system. It can be said that China's "system environment" generates a structural force which dictates the current trend of reform as well as behavior of government and business enterprises. Although all are aware that the ultimate result may prove undesirable, but driven by such a structural force, they nevertheless flock towards it.

China should not go any further along the current reform path. Over one century ago, China's approach to modernization was "using traditional Chinese learning to set up the structure and using Western learning for practical purposes." The goal of modernization was "to enrich the nation and strengthen the military." The economic reform that began twenty years ago basically followed the same logic (Marxism as the structure, Western technology as practical means). Such logic determined that the focus of China's modernization would be survival and economic development while discouraging innovation in ideology and fundamental changes in the political system. Such logic also determined that China, after hobbling along for over a century, would remain a latecomer in modernization.

As is shown by history, developing countries currently engaged in the modernization process are far more limited in their resources and more burdened by over-population compared to developed countries in their pre-development days. Under such circumstances, developing countries must think clearly and have a vision, which means setting up a rational system of environment for business enterprises and an effective legal framework for the market. A Sweden economist once sounded a warning to developing countries: "It may be difficult to understand, but an obvious fact has been covered up in works of economics: overall the technology of developed countries has exerted and continues to exert a negative impact on the development of developing countries." The reason is that, in terms of level of development, there exist qualitative as well as quantitative differences between developing countries and developed countries. Some believe that China's modernization is but a few years behind. The basis of such a "time lag theory" is "periodical development theory," which in turn is based on metaphysical biases.

For over a century, China has been trying to catch up with developed countries in modernization. At present, the most important thing is to understand the fundamental reasons why China has lagged behind. If China only focuses on the import of certain technologies instead of creating a social system conducive to modernization, the result would be building a skyscraper on sand, whose foundation at best is shaky. If we press on along the same path, China is likely to remain a latecomer for another hundred years. Chinese scholars should have the courage to conduct, from different dimensions of political science, economy, or philosophy, a critical review and examination of various issues revealed in the reform process, including but not limited to poverty, distribution, wealth accumulation, and build up a new value system to promote a historical transformation of China's economic and political structure.