

**THE IMPORTANCE OF POLITICAL INSTITUTIONS ON THE
ECONOMIC DEVELOPMENT OF CHINA (1992—2004): WHY
THE PRESENT POLITICAL INSTITUTIONS OF CHINA
REQUIRE FUNDAMENTAL CHANGE**

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ABSTRACT

Title: The Importance of Political Institutions on the Economic Development of China (1992--2004): Why the present political institutions of China require fundamental change.

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This research investigates the relationship between political institutions and economic development and highlights the impact of political institutions on the economic development in China from 1992 to 2004 by discussing the reasons why the present political institutions in China require change. It is argued that political institutions could influence economic progress if the effect and role of political institutions - both positive and negative - is recognised. Two case studies are employed as examples of how the absence of appropriate political institutions affects the positive performance of the economy and how this is associated with China's history and the way in which economic reforms have been conducted. It is concluded that under the political monopoly of the single party, economic progress and development will be blocked and hijacked by the authorities and interest groups in China.

Since its reform and opening up to the outside world, China's economy has so far seen an enormous growth, but these achievements are impressive merely in the short-term, and give a false impression of the economy's development. The free market economy system requires political reform but the Chinese Communist Party monopolizes all social resources and engages only in economic reform without political reform. This is what could be termed the "curse of the latecomer": the long-term interests of the nation have been sacrificed and this may result in many hidden risks or even the failure of long-term development.

This research identifies the major factors affecting the development of a country's society and economy. Political science theories about property rights and the State, and Institutional Change of New Institutional Economics are used to explain and support the standpoint of this thesis. Two case studies will be used in order to show how these theories are occurring in practice, which are the incidents concerning Yang Rong and Sun Dawu.

The former will prove that it is necessary for property rights to be specified and enforced, and it is harmful to economic development when the government uses its political power to intervene in the economy. The latter case study will illustrate that the unfair monopoly and interventionist behaviour of government and a relatively defective legal system are not apt in facilitating the performance of China's economy.

The conclusions of this study stress that institutions are the determinant of economic performance and that institutional changes are likely to occur when the existing institutions fail to satisfy people's demands. Such a development appears essential for China to progress further.

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ABBREVIATIONS

CCP	The Chinese Communist Party
CPPCC	The Chinese People's Political Consultative Conference
CYL	The Communist Youth League
CYP	The Communist Young Pioneer
CPSU	The Communist Party of Soviet Union
ECE	Eastern and Central Europe
GDP	Gross Domestic Product
GNP	Gross National Product
GLF	The Great Leap Forward
GOVIA	Gross Output Value of Industry and Agriculture
GDR	German Democratic Republic
KMT	Kuomintang or the Nationalist Party of China
NRM	National Revolution Movement
NIE	The New Institutional Economics
NPC	The National People's Congress
NRM	The National Revolution Movement
NCP	The National Congress of People
PNC	Party National Congress
PPP	Purchasing Power Parity
RTVES	Rural Township and Village Enterprises

SOE	State-Owned Enterprise
TVE	Township-Village-Enterprise
USD	United States Dollars
USSR	Union of Soviet Socialist Republics
WTO	The World Trade Organization

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CHAPTER ONE

INTRODUCTION

1.1. Overview

The Third Plenary Session of the 11th Central Committee of the CPC in 1978 marked the beginning of China's reform and opening-up drive. Since then, the structures of its political and economic systems have shown themselves to be at times unbalanced and inconsistent, and have even made economic development unmanageable. China has really only dipped a toe into the waters of the 'Promised Land of The Market System' whilst remaining firmly rooted in the old framework of centrally-directed controls (Hu, 2005). This thesis will argue that the conflict between politics and economics has led to an imbalance between interests and benefits. This imbalance is the result of a lack of reform of political institutions, which has led to the slow evolution of economic institutions, marked by stagnation and conflict. The development of any human society is based on the underlying political, economic, social, historical and cultural conditions. The lack of change in the political institutions in China has meant that China's economic development has been hampered by a particular inflexible order which is not related to political, financial, social and other sources as is the case in other capitalist economies. Only when we fully understand the political institutional changes needed in China can we find a path of sustainable economic development.

The central argument of this thesis is that the CCP's political institutions have created a structurally unstable environment for China's development to date, a fact that they themselves acknowledge. The next phase of China's political and economic development must address this issue in order to permit more political and economic pluralism. That will set in train a process that will in turn challenge the institutions of the CCP. The present political institutions in China have to change completely because the situation is disadvantageous to economic development and even obstructs

social benefits. This must encompass the CCP's political institutions and economy because an institutional structure that includes political, social, and economic institutions can help promote beneficial human exchange and social development as successful institutions will obtain successful results and institutional change can shape the way societies evolve through time. "The rule of law, the independence of the judiciary, the freedom of the press, the scientific and representative, accountable, checked and balanced government - all these flowed from the great intellectual, philosophical and political wellspring that we call the enlightenment" (Hutton, 2007: x). The weakness of the CCP's political institutions, assuaged only partially by the current false prosperity, is matched by a growing awareness of the logic of political reform, and China is rapidly heading for a decisive moment. The current halfway house of trying to retain political control of what is in truth only half a market economy is unsustainable. China has to accept that economic pluralism, along with an institutional infrastructure to confer political pluralism, is the only way in which a market economy can flourish. China's current economy is unstable, unbalanced, uncoordinated and unsustainable (Hutton, 2007: 8).

This thesis traces back the history of the CCP regime to expose the substance of the Party. It also studies the reform and opening up policies of the Communist Party since 1978 and assesses the outcomes of the reforms. China's economic development has simply imitated the industrial pattern of capitalism, in which the means of production and distribution are privately or corporately owned and development is proportionate to the accumulation and reinvestment of profits gained in a free market. This potential for imitation has now been exhausted, and the curse of the latecomer has led to the discovery of many hidden risks or even failures in long-term development, even though it has generated short-term economic growth (Sachs and Woo, 1994a). Furthermore, the present communist dictatorial system understands the need for a solution to this problem. This thesis will investigate how the CCP's political institutions have seriously hampered economic development. The CCP's single-party dictatorship has led to many social, economic and political problems, even disasters.

The only way out of this is to make radical, even seismic, changes to the current political and economic institutions.

The literature review encompasses new economic theories concerning institutional change, political theory about property rights and the State, such as a theory of the State that provides services, successful policies, the allocation of social resources and specifies and enforces property rights and a theory of the State which argues that the existence of a State is essential for economic growth. It also examines the source of man-made economic decline as well as path dependence that has a strong restrictive function on institutional changes and is also a key factor which contributes to economic growth (North, 1981: 7-8). This study is supported by this literature review. For analytical purposes, it is essential to look at the development and meaning of these theories of political theory and institutional change. It will be concluded that there is a truly established normative analysis model-pattern of the four forces (forces of Government; Law and Common Norms; Social Members; and Enterprises. See chapter 6.3.) in institutional change. The persuasiveness of a theory depends not only on how many facts are explained, but also on how diverse these facts are (Olson, 1982: 13). In addition, other points of view will be shown.

In order to achieve these objectives several different kinds of methods had to be explored and combined together to form the research methods used in this study. This thesis will focus on the study of positive analysis mainly, adopting the combination of positive analysis and normative analysis and quantitative and qualitative analysis, case studies and interviews. A multi-method approach has been adopted for the research, including a scrutiny of all relevant policy. Among all these methods, selection of an appropriate methodology and the choice of suitable techniques are of paramount importance; as Jankowicz stated, the use of methods is as important as the pilot who flies planes (Jankowicz, 1995).

The conclusion of this study stresses that due to the political monopoly of the ruling

party, economic reform and development is influenced and hindered by the political institution and the present political institution of China has to be changed completely. It must recognize that liberalization and privatization reforms will increase the efficiency coefficient. This will speed up the convergence of the economic system towards equilibrium (Sachs, Woo and Yang, 2000). The traditions of democracy, liberty, social order and morality are the only road for China in the future. “The opportunity set faced by a society, then, is partly defined by its institutions. This is their primary consequence, and modifying them brings forth a new mix of opportunities” (Menard, 2000:69).

This thesis (and its original research) differs from others in several respects. First, the thesis elaborates why the existing political institutions in China have to be changed and how the political system acts on the economy by analyzing the Chinese economic situation and social problems, based on a large number of valuable interviews and political and economic data (for example, 23 tables and graphs). It combines economic analysis with political analysis that is used to explain the problems facing China. Secondly, this thesis illustrates problems with positive evidence and indicates the author’s attitude and values with normative evidence. Any theory has its potential judgment of value. Researchers are not only researchers but also humans and so their judgment will inevitably influence their research. Thirdly, the source of quantitative materials is preserved in order to increase the objectivity of the inquiry and allow the opportunity for readers to come to their own conclusions. Fourthly, this thesis will use the normative analysis model-pattern of the four forces in institutional change that the author of this thesis created himself.¹ Finally, the thesis utilises many original interview materials through interviewing many different kinds of interviewees, and these original interview materials will help to support the topic of the thesis.

¹ Researchers might ask where the models are, what the samples are and what the results of the statistical examinations are. Strictly speaking, the models in this thesis are merely an analytic framework rather than a mathematical analysis.

1.2. Subject, Purpose and Scope of Thesis

The subject of this thesis is the effects of political institutions on the economy in contemporary China and how it has to be changed in order to remove barriers in the course of China's developing economy and society. One main objective of this research is to describe how and why the present political institutions influence the economic benefits due to the relationship and interlinking of politics and economics and their interaction with each other. Politics and the economy has inevitably interlinked and so a country has to develop a true political and economical tenet in order to understand the performance of an economy (North, 1990). Up to now, China still does not specify and enforce the property rights which shape the basic incentive structure of an economy and because the CCP plays an important key role in the economic performance of China, this will probably adversely affect interested groups. It must recognize that the decisions made by the political process critically affect the functioning of economies; otherwise, we will never resolve the problems that have to be confronted. According to North (1990: 112), "Although at a special level we have begun to recognize this, much more integration of politics and economics than has been accomplished so far is needed. This can only be done by a modelling of the political-economic process that incorporates the specific institutions involved and the consequent structure of political and economic exchange"²

² It is worth looking at John Coatsworth's characterization of the institutional environment of nineteenth-century Mexico: "The interventionist and pervasively arbitrary nature of the institutional environment forced every enterprise, urban or rural, to operate in a highly politicized manner, using kinship networks, political influence, and family prestige to gain privileged access to subsidized credit, to aid various stratagems for recruiting labour, to collect debts or enforce contracts, to evade taxes or circumvent the courts, and to defend or assert titles to lands. Success or failure in the economic arena always depended on the relationship of the producer with the political authorities—local officials for arranging matters close at hand and the central government of the colony for sympathetic interpretations of the law and intervention at the local level when conditions required it. Small enterprise, excluded from the system of corporate privilege and political favours, was forced to operate in a permanent state of semi-clan destiny, always at the margin of the law, at the mercy of petty officials, never secure from arbitrary acts and never protected against the rights of those more powerful" (Coatsworth, 1978: 94). Here, personal relationships are still the key to much of the political and economic exchange.

A further main objective is to realise that “we made institutions the determinant of economic performance” (North, 1990:7). Furthermore, there will be an attempt to answer the “how” and “why” questions with regards to how political institutions influence the development of the Chinese economy. This thesis will assess China’s results since 1978. The study as a whole seeks to answer three major questions. Firstly, what were the reasons to only choose the special term of 1992-2004 to start analyzing why the Chinese present political system has to be changed completely? Secondly, why the present political institutions require change: is it because of the CCP’s role and institutions, or are there also other reasons? Thirdly, in relation to the previous two questions, what is China going to do to change the political system in order to develop its economy? Answering these questions will help us to decide what the future of China is and will highlight the importance of two points. It will attempt to show that institutions do matter. The Chinese economy has increased rapidly since China’s reform and opening to the outside world, but the reforming policies all stem from the decisions of the CCP’s regime, that is to say, a top-down approach to decision-making. This reform is a result of political demand and political power determines the reform and economic development. It also draws attention to the necessity of analyzing the growth of economies within well-developed institutional frameworks in the light of theories of institution change. The CCP’s institutions govern the performance of an economy because the results of the productivity of the system depend on the institutions of a country: its legal system, its political system, its social system, its educational system, its culture and other systems.

The main purpose of this thesis is to discuss the obstacles to China’s economical development and the possibility for an institutional arrangement for China’s problems at present, which is lacking political reforms such as property rights reforms, the reform of the role of the state or government and institutional change. In order to find a comprehensive answer to these problems, it will first be attempted to look back on the history of the CCP and its impact on the economy. This is important in order to understand how the political power of the CCP has influenced China’s economy and society since it took power in mainland China. Furthermore, the analysis of the

development of the nation is important and necessary in order to understand how China's economy has suffered heavily from its short-term operations. After this analysis, this thesis will attempt to answer the question of whether or not the present political institution has to be changed. As North (1990) stated, one of the most important conclusions to be drawn is that the institutional framework plays a major role in the performance of an economy. The way institutional constraints evolve through time and thereby determine the performance characteristics of economies is of great concern.³

The scope of this study is limited in several ways. Firstly, it deals with concepts and theories of politics and economics but the thesis only uses the ready-made results such as theories of state and property rights from political theory and the theory of institutional change from economic theory in this study rather than attempting to prove these theories, and it does not consider or assess the course of these theories' evolution. Consequently, there are a number of immaterial concepts and theories and inferences not included in this study. The dispute between technology and institution change, for example, is excluded because, although it was an interesting issue, it was not directly related to the impact of political institutions on the development of a country's economy. Secondly, while the methods of social research and economics are used in this thesis, such as quantitative and qualitative analysis, the case method, interviews and positive analysis and normative analysis, this research only uses what is relevant for this thesis from economics and sociology. In addition, this thesis focuses on the impact of political institutions on economic development and so both theories of state and property derived from political theory and the theory of institutional change from economic theory will be used. However, the theory of institutional change in fact stems mostly from Douglas C. North's work, which won the Nobel Prize. "Unfortunately, there has been little theory to help

³ However, North explains: "I have been at pains to point out that some institutional constraints raise transaction costs. Therefore, the market overall is a mixed bag of institutions; some increase efficiency and some decrease efficiency. Nevertheless, contracting the institutional framework in countries such as the United States, England, France, Germany, and Japan with Third World countries or those in the historical past in advanced industrial countries makes clear that this institutional framework is the critical key to the relative success of economies, both cross-sectionally as well as through time" (North, 1990:69).

understand the phenomena of institutional change” (Davis and North, 1971:3). In this thesis, I will only draw on North’s theory of institutional change, which is one of his most influential theories. Finally, to further understand how important institutional change is, case studies will also be used in this research. It will also use both the theory of the state and the theory of property rights from political theory as well as path dependence, as although it is not a theory but a concept, it is quite important in institutional change for analyzing case studies.

The period in question (1992-2004) holds particular significance. Before 1992, the CCP aimed to “Bring Order out of Chaos”⁴ and by taking the planned economy as a given, then established a planned commodity economy for the Chinese people.⁵ It has been chosen to coincide with the turning point that established the market economic structure which started from 1992. During this period, establishing a socialist market economy was described as “not only a great theory breakthrough, but also a decision with era significance”⁶ and China’s huge changes in its economy and society caused many problems to start becoming exposed during this period. Therefore this thesis takes its starting point as 1992 up until 2004 and does not need to carry out an analysis of the whole period from when the CCP took power in 1949.

⁴ The Third Plenum of the 11th Central Committee of the Communist Party of China, held in December 1978 in Beijing. The plenum profoundly reviewed the lessons drawn from the “cultural revolution” and broke down the long-standing shackles of the “Left’s” erroneous ideology. This central committee discussed the transition of the CCP’s work, determinedly shifted the focus of the work of the Party and the State to the socialist modernization drive and implemented the reform and opening-up strategic decision, which is termed “bringing order out of chaos”. (Communiqué of the Third Plenum of the 11th Central Committee s (1978). The Red Flag Press (Chinese edition); also see chapter 4.3.2.

⁵ In October 1987, the 13th Party National Congress was held in Beijing. This Party Congress asked to establish the basic framework of the planned commodity economy new system step by step. The Congress announced a quick establishment and growth of the socialist market system, and the creation of a new basic framework of a planned commodity economy, in which there would be added a more free market economy and central planned economy would be reduced. (Communiqué of the Thirteenth CCP National Congress (1987), The Red Flag Press (Chinese edition); also see chapter 4.2.3)

⁶ Communiqué of the Fourteenth CCP National Congress (1992). The Red Flag Press (Chinese edition).

1.3. Background of Research

China has never refrained from pushing forward its reform and opening up policy and since 1978 set the goal of building a socialist society with Chinese characteristics. A boom in the development of its economy not only made the CCP greatly satisfied but also some theorists and academics. They think that the dual track approach, namely the central planning system and the market system, are suitable for China, in which the autocratic and dictatorial political system can still be kept, and the rule of law and system of liberty do not have to be inevitable. However, in fact, the resulting hybrid system is not without some serious problems. The combination of private ownership and administered pricing may well be predisposed toward a misallocation of resources and serious corruption, a privileged class, free riders and so on (Sachs, 1999). “This underscores one of the great ironies of the new China: as a reflection of this deep-rooted and understandable caution, the central planners keep a firm hold on their political power in order to control the whole of China”⁷ (Roach, 2006: 17). China has not chosen to rebalance its economy, for example, certain phenomena have arisen from excessive growth in industrial activity, and external tensions that have stemmed from the backlash of China’s trading partners have not eased. The CCP is not moving toward a more balanced growth model either, as the CCP leadership has still made a conscious decision to accept average GDP growth of 7.5% over five years up to 2010, even though this is a significant downshift from the 9.5% pace of the past 26 years (Roach, 2006). China should, in effect, have shifted its emphasis from the quantity to the quality of economic growth which would enable it to better cope with changes in levels of pollution and other forms of environmental degradation, monitor the safety of workers, and manage increasing inequalities in income.

⁷ That is certainly true of the legacy system of administered pricing of many goods and services that still exists for utilities, public transport, coal, natural gas, oil, gasoline, and indirectly for food due to state-sponsored agricultural inventory management programs. But it is also true of the prices on a variety of financial instruments—namely, interest rates, the currency, bank credit lines, and bond prices. These prices are still tightly controlled by leadership decisions made at the highest levels of the Chinese power structure.

In China, the dual track approach institutionalizes all arrangements, and so government officials do not only become the rule maker, but they are also at the same time the rule enforcer, the referee, and the player (Roland, 2000). The most important characteristic of China's market-oriented reforms is the absence of a constitutional order and rule of law. This implies institutionalized state opportunism, the ruling class managing itself, and rampant corruption as market-oriented reforms are carried out in the absence of constitutional order. Hence, the most efficient way to initiate reforms is to remove government officials' control rights through the kind of privatization reform seen in Eastern Europe and Russia. However, as Sachs and Pistor (1997) suggest, the success of the rule of law, liberalization and privatization reforms is dependent on the transition of institutions. "Nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law. Stripped of all technicalities this means that government in all its actions is bound by rules fixed and announced beforehand—rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one's individual affairs on the basis of this knowledge"⁸ (Hayek, 1944: 54).

The planned economic system, rigid and single arrangement of the enterprise system, and endless political movements, have neglected the interests of individuals and companies and chilled the enthusiasm of these enterprises and their staff, which has caused a general exhausted vitality among all concerned (Sachs, Woo and Yang, 2000). In the past 26 years, the national economy has been growing at high speed. But this rapid growth has been at the cost of a large amount of natural resources and poor economic results. Investments are accumulating with less consumption, causing a serious shortage of materials and a poor quality of life in both urban and rural areas. China is in a very difficult financial situation, resulting in an imbalance of state

⁸ According to the classical exposition by A. V. Dicey in *The Law of the Constitution* (8th ed., p.198) the rule of law "means, in the first place, the absolute supremacy or predominance of regular law as opposed to the influence of arbitrary power, and excludes the existence of arbitrariness, of prerogative, or even of wide discretionary authority on the part of government" (quoted from Hayek, 1944: 54).

revenues and expenditures (Roach, 2006). At the same time, long-established capitalist countries in West Europe and Japan, Korea and Singapore in Asia are all embracing the golden period of post-war economic development, which will leave China further behind those developed and developing countries. Contrary to its expectations, the CCP has failed to achieve its goal of rapid economic growth and its public image of success could soon be challenged.

1.4. Structure of the Thesis

This thesis consists of seven chapters and a conclusion. Chapter One is the introduction, which explores the main problem of the thesis by selectively surveying literature on theories of property rights and the state, and the theory of institutional change. The thesis has framed its own conceptual approach and the assumptions on which the thesis are constructed are based on the following factors: the chosen topic, a robust theoretical and conceptual framework, relevant academic literature and a clear methodology.

The second chapter details the political and economic theories concerning property rights, state and institutional change. A theory of the state describes the individual and group incentives in the system; a theory of property rights specifies and enforces property rights; the institutional change explains how the supply of resources from an institution is limited and scarce because of the limit of people's rationality and the scarcity of available resources. With changes in the external environment or the improvement of individual rationality, people will constantly make new demands on their institutions in order to gain expected additional funds. The study will be supported by this literature review and will be used as a reference in subsequent chapters.

Chapter Three of this thesis is concerned with the development of research in social and economic methodology, in which positive analysis is to be used as a major

method. Normative analysis, quantitative and qualitative analysis, case study method and interviews will also play an important role in this study. A multi-method approach has been adopted for the research, including a scrutiny of all relevant policies.

Chapter Four analyses how China's economic development was essentially a result of imitating the industrial pattern of capitalism and that this potential for imitation has been exhausted. It explores how the "curse of the latecomer" may cause many hidden risks or even failure for the country's long-term development, even though it can generate short-term economic growth. The CCP political system has seriously hampered China's economic development, and the CCP single-party dictatorship has brought up many social, economic and political problems, even disasters. The only way out is to make a thorough change to the current political and economic institutions. This chapter discusses how the present political institutions of China have to be completely changed. China has now become a nation with some of the most serious economic inequalities in the world despite the fact that China's GDP is increasing each year. Facing a crisis of survival, the CCP was forced to reform China's economy in the 1980s but it still follows in the footsteps of the former Soviet Union and Eastern European communist regimes.

The fifth chapter is devoted specifically to an analysis and assessment of the accomplishments of China's reform and opening up to the outside world since 1978. At the beginning of the reform of its economic system, China's economy developed rapidly and many achievements have been gleaned since 1978 as a result of this opening up. China's social productivity and comprehensive national power has constantly been enhanced, and the overwhelming majority of Chinese people have witnessed a historic transformation in their society's overall living conditions. However, the CCP has also caused many problems that have blocked social and economic development because they have not attempted political reform.

The sixth chapter contains a case study detailing the incident concerning the businessman Yang Rong, and the media investigates the development of the case and

shows how this is illustrative of many similar issues in contemporary China. The author discusses the findings from the analysis of data collected from survey interviews with key people involved in this incident. In all, 36 interviews were conducted with a range of the significant people involved, including top managers, directors, staff and government officers. In tracking this case, it is easy to see the impact of political institutions on economic development in China and how the government is able to exert its power, at any time, through government administration, the police, jail sentences and even by illegally changing the law in order to do whatever it wishes.

Chapter Seven is also a case study, and details the Dawu's incident. In total, 26 people were interviewed and through this example of a typical case study, the phenomenon of how the government serves as an agent of the state organs will be analysed, showing how it must be accountable for economic growth or decline if it decides to intervene in the development of enterprises. Governments cannot monopolise a set of functions or services and should instead act as a service organization, using its guidance and power wisely in line with the superiority of their political positions and the allocation of resources at their disposal.

The last chapter is the conclusion of this study. It stresses that under the political monopoly of the ruling party, economic reform and development will be influenced and hindered by the political system and therefore the present political system of China has to be completely changed. Institutions are a driving force in economic growth. Production can be increased and economic growth can be promoted through institutional change and reform. Democracy, liberty, social order and traditional morality are the only road for China in the future. Recommendations, drawing on the results of the study, will conclude the thesis with an analysis of and reflections on this research.

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This thesis will use a theory of institutional change which is one of the theories of the New Institutional Economics (NIE)⁹, whereby a theory of institutions is incorporated into economics. As pointed out by Helmes (2000), since the 1980s, institutions have been ‘rediscovered’ on both sides of the Atlantic. “New institutionalism” in its various forms has become highly influential. It builds on, modifies, and extends neoclassical theory, retaining and building on the fundamental assumption of scarcity and hence competition. It has developed as a movement within the social sciences, in particular economics and political science, and unites theoretical and empirical research which examines the role of institutions in furthering or preventing economic growth. It includes work in transaction costs, theories of institutional change, political economy, hierarchy and organization, and public choice. North’s theory of institutions is constructed from a theory of human behaviour combined with a theory of the costs of

⁹ “The phrase, ‘the new institutional economics’ was coined by Olive Williamson. It was intended to differentiate the subject from the ‘old institutional economics’. John R. Commons, Wesley Mitchell and those associated with them were men of great intellectual stature, but they were anti-theoretical. ...I am delighted when our colleagues in law use them to study the working of the legal system or when those in political science use them to study the working of the political system.” (Menard, Claude 2000: 3-4).

transacting.¹⁰ When combining them, it can be understood why institutions exist and what role they play in the functioning of societies (North, 1990).

In this thesis, two theories of political theory will be employed, namely the theory of the state and the theory of property rights. This is because Chinese property rights are vague to a certain extent, and because of the abuse of political power by the CCP and both of these factors have led to a series of issues that will be discussed in subsequent chapters. As Heywood (2004: 316) says, almost at every level politics is intertwined with economics. Politics can limit economic options and political forces can shape, modify and influence economic structures or processes. The distribution of economic opportunities and government economic policy-making across a population at any time depends quite largely on political power (Bowles, Maurizio and Pagano, 1999).

2.2. Institutions and Institutional Change

In Chinese, there is no difference between the words “institution” and “system”- both have the same translation and meaning. However, in English, the word “institution” is more abstract, whereas the word “system” is more concrete. “In the case of *political or economic institutions*, wealth or utility is maximized by exploiting the gains from trade which are a result of specialization” (North, 1981: 202). An institution is the rules of play, so to speak, using humanly devised constraints to structure human

¹⁰ The costs of transacting or transaction costs: the costs of resources utilized for the creation, maintenance, use, and change of institutions and organizations. They include the costs of defining and measuring resources or claims, the costs of utilizing and enforcing the rights specified, and the costs of information, negotiation, and enforcement. According to Coase (1937: 114), “in order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal with and on what terms, to conduct negotiations leading up to the bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on.” In addition, Coase (1988) states that his conclusion was: “...the ultimate result (which maximizes the value of production) is assumed to work without cost.” This conclusion was formalized by Stigler as the ‘Coase Theorem’, which he expressed as follows: “...under perfect competition private and social costs will be equal.” His article, *The Problem of Social Cost* (1960), emphasizes the effect of the law on the working of economic systems.

interaction. These are made up of formal constraints (such as rules, laws, constitutions), informal constraints (such as norms of behaviour, conventions, self-imposed codes of conduct), and their enforcement characteristics. According to Douglas C. North (1981:201), “Institutions are a set of rules, compliance procedures, moral and ethical behavioural norms designed to constrain the behaviour of individuals in the interests of maximizing the wealth or utility of principals.” There is some interaction between these institutions and they have an influence on each other, providing a framework within which human beings interact and which can offer a space of cooperation and competition for people’s economic order. North (1990: 7) said in his theory of institutional change, “We made institutions the determinant of economic performance.”

The resultant path of institutional change is shaped by “the lock-in that comes from the symbiotic relationship between institutions and the organizations that have evolved as a consequence of the incentive structure provided by those institutions; the feedback process by which human beings perceive and react to changes in the opportunity set” (North, 1990:7). Changes in the institution will occur when the existing institution fails to satisfy people’s demands. The ratio of the costs and benefits will play a key role in promoting or delaying the institutional changes. Only when the expected benefits are more than the expected costs, will the behavioural agents begin to make the institutional changes possible, and vice versa, and this is the law of institution changes. Skocpol and Weir (1985) claim that institution change is linked with ideas and ideas are relevant causal variables only if a prior institutional configuration selects for them and that ideas must somehow be suitable to pre-existing institutions. Blyth (2002: 22) points out that if new ideas are to be readily accepted by existing institutions, then we have two possible conclusions: “Either such ideas act as catalysts that speed up change, or, far from ideas being powerful forces for change, the ideas in question can be readily accommodated and pose little challenge to existing policies and practices.”

In the theory of institution change, path dependence is a rather important concept. It can be described as something like inertia in the field of physics. A state will go along the path of an institution once it decides upon it, whether it is advisable or not, and will depend upon it. It is difficult for a society to divorce itself from its established institutions unless there are exogenous variables or unexpected events. As North puts it, what people decide on determines their present possible choice. Political and economic institution changes will show a positive circle of growth, rapid optimization along their decided paths, or will decline by the old wrong path. The mechanism of path dependence may even have institutions locked in inefficiency. Once an institution is trapped in a lock-in, it is very hard to escape from it without the help of exterior forces or exogenous variables. Path dependence has a strong restrictive function on institutional changes. It is also a key factor which affects economic growth.

The course of China's political and economic reforms is in fact a course of important institution changes. On the one hand, the backward natural economy of autarky turns to market economy, which is similar to that of most developing countries. On the other hand, the traditional system of planned economy turns to that of market economy, which is similar to that of most socialist countries in a sense. Obviously, China's political and economic reforms are not the same as usual amendments or transformations. These reforms are in fact changes from dictatorship to democracy and freedom, from a traditional economy to a market economy. From this point of view, the course of China's political and economic reforms is actually a course of institution changes and it is a profound institution revolution. The complexity of both political and economic reforms determines the difficulty and slow progression of the institution changes. "There are a number of more subtle ways by which political institutions can change. Among them a change in composition of the political elite working within and through political institution seems to be of particular importance" (Dietrich, 1990: 48).

Lachmann (1970: 36) argues that “different men in identical situations may act differently because of their different expectations of the future.” As a form of institution change, China’s political and economic reforms have, undoubtedly, problems of path dependence. On the one hand, the initial project and choice of institution are important. The market trend, which China chose and its target of establishing a market economic system, have proven to be correct in practice. On the other hand, in the course of its reforms, the political classes with vested interests have tried to maintain the existing institutions and block further political and economic reforms. Hence, the success of China’s economic reforms and the realization of its target of establishing a market economy depend not only on the reformists’ subjective and ultimate objectives, but also on whether the problem of path dependence can be solved. Especially at this present state of deep structural reforms, the political classes with vested interests have become an obstacle to further reforms. How to weaken this impediment and incorporate fresh forces are the problems which need to be solved in China’s further economic reforms in order to realize a true political and economic shift.

2.3. The Theory of Property Rights and the Theory of the State

2.3.1. The Theory of Property Rights

The Oxford Law Dictionary defines the right of property as: “the ownership of property, and any object or right that can be owned.” It includes the right to possess, the right to use, the right to lease, the right to transfer, the right to dispose and other rights related to property. “Property rights are the rights of individuals appropriate over their own labour and the goods and services they possess. Appropriation is a function of legal rules, organisational forms, enforcement, and norms of behaviour—that is, the institutional framework.” Sheng (1994) argues that there are two distinct meanings: economic property rights and legal property rights. The economic property rights of an individual over a commodity or an asset are the

individual's ability, in expected terms, to consume the goods or the services of the asset directly or to consume it indirectly through exchange. These can include a) the right to use an asset; b) the right to earn income from an asset and contract over the terms with other individuals; and c) the right to transfer ownership rights permanently to another party. The legal property rights are the property rights that are recognised and enforced by the government.

According to the theory of property rights, it is efficient to solve the problems of scarcity and competition which fill the world with the lowest cost of the forms of property rights under the restriction of the existing technologies, information cost and future uncertainties. As pointed out by Barzel (1989), all governments play an important role in property rights, and sometimes governments' roles are enormous, as governments themselves also possess national properties. Governments serve as an arbitrator to adjudicate and enforce contracts, and sometimes even invest or have a hand in economic activities directly. Although governments always engage in non-business activities such as conducting foreign affairs and operating the courts, these activities actually relate to business to a certain extent, usually for profit. Property rights which increase government efficiency have been tried or advocated. "We recognize the influence of property rights and appropriability in assessing the use of experts and scientific advisors by governments" (Furubotn, 1974: 185). As Cheung (1982: 34) argues "if property rights change, the organisational forms will probably change."

Property rights constitute the institution framework. The inefficiency of the property rights structure inevitably results in the inefficiency of the institution structure. Consequently, one of the important components of institution innovation is the innovation in the structure of property rights. Specification of property rights and the rectification of an irrational property rights structure must be the premise and power through which reforms and institution changes can be promoted. China's economic reforms began with the planned economy. With the old single state ownership, the

property rights structure was a defective, inefficient mechanism without incentive and power and there were many complicated problems in property rights, which become a fundamental impediment to further reforms. Thus, in the incident concerning Yang Rong, Yang Rong in fact claims that 70% of enterprise stock ownership belongs to him because China's Finance and Education Development Foundation did not invest any money in the enterprise. However, because the government thinks of Hua Chen group as state property, it embarked on an overall takeover. Yang Rong explains that the government foundation can only share the rights and interests of a certain proportion of the investments within lawful range and so he used the name of the Foundation to allow his company to enter the market. However, as this case did not lead to an adjustment in relations between Chinese enterprises and the Chinese government, the biggest private car manufacturer in China disaggregated and Yang Rong escaped to the United States for fear of being persecuted. Clearly, these property rights have stagnated the development of Chinese enterprises and therefore China must quicken the course of its property rights reforms. Either a policy-analysis organization, or through effectively organizing ideological and public relations campaigns, all of them need economic resources in order to be politically successful (Knuttila and Kubik 2000). Therefore, with reference to the theory of property rights in institution changes, China has to attach great importance to the reforms of property rights, especially in order to for these reforms to reach a deeper structural stage. The property rights reforms require a broad emancipation of minds and great advances in order to clear obstacles to China's overall economic reforms and institution changes.

2.3.2 The Theory of the State

According to Bluntschli (1895), the theory of the State is at the basis of the two political sciences, Public Law and Politics. In the modern world, the state is the most important key to economic performance because of its share of gross national product moving through government and the ubiquitous and ever-changing regulations imposed by it. The State helps a country to provide cheap energy for heavy users

through the pricing policies of nationalized industries in order to defray the costs of production for capital and it also provides a range of benefits for organised labour (Held, 1984). First of all, a theory of the State has to explain the nature of the state. There are many examples of the nature of the state illustrated in politics and history. But two general types of explanation for the state exist: a contract theory¹¹ and a predatory or exploitation theory. Contract theories of the State have a long history. The contract approach may explain why the State takes on the role of wealth-maximization for society, as the state can potentially provide a framework for economizing the use of resources and can also promote wealth. The State becomes a battlefield for controlling the decision-making power, because the state becomes the third party in every contract and is the ultimate source of coercion. The contract theory is very important for economic growth as it limits every individual activity relative to others.

The predatory or exploitation theory thinks of the state as a certain agency of one group or class. The state's role is to take the wealth and income from the members of a group or class on behalf of the interests of the group or class. This theory specifies a series of predatory rights in order to maximize the wealth and income for the group or class under power, but in the meantime, it may ignore the influence on the revenue of society as a whole. Popper (1974) claims that we may distinguish two main types of government (in state). The first type is the democratic State, which changes state power by way of general elections. That is to say, "the social institutions provide means by which the rules may be dismissed by the ruled, and the social traditions

¹¹ This view is derived mainly from Jean-Jacques Rousseau (1712-1778). Jean-Jacques Rousseau is one of the most influential thinkers during the Enlightenment in eighteenth century Europe. His first major philosophical work, *A Discourse on the Sciences and Arts*, and his major work on political philosophy, *The Social Contract* were both published in 1762. In *The Social Contract*, Rousseau propounds a doctrine which already had a long history in the struggle against the older view of the divine right of kings, namely, that the government obtains its authority over the people by a willing consent on the part of the people, not by the authorization of God. Leaders of the French Revolution championed his political ideals (<http://www.iep.utm.edu/r/rousseau.htm>).

ensure that these institutions will not easily be destroyed by those who are in power” (Hayek, 1976:193). The second type is the “tyranny” or “dictatorship” State, which typically can only be changed through a successful revolution resulting in bloodshed and violence. “The really crucial formal feature of the State, which has most continuity and certainty in all States, is that it is a continuous public power. This public power is formally distinct from both ruler and ruled. Its acts have legal authority and are distinct from the intentions of individual agents or groups. Thus the State, as public power, embodies offices and roles, which carry the authority of the State. The State embodies fundamental human values and aspirations” (Vincent, 1987: 21). Poggi (1978), Badies and Birnbaum (1983) claim that the State is central to other disciplines being ‘off limits’ to sociology. New Right belief states that the State is a parasitic growth which threatens individual liberty and economic security, that it is a self-serving monster, a ‘nanny’ or ‘leviathan’ state, which interferes in every aspect of life (Heywood, 2004).

Both case studies in this thesis illustrate the negative effects that State political power causes through excessive intervention and monopoly. In the example of Yang Rong, the local provincial government was able to easily deprive Yang Rong’s private property rights with an internal file and local government regulations which had power beyond the rule of law. In fact, many private enterprises have been confronted by the dilemma that political power is much stronger than law. Governments can provide preferential policies for enterprises in any name, and can also cause trouble for any enterprise without any reason for this. In the case of Sun Dawu, the government’s monopoly over banks and their ability to grant loans meant that the Dawu group was not able to obtain a local bank loan simply because Sun Dawu was reluctant to bribe bank officials and exploit corrupt means in order to gain favours and benefits. Instead, local people invested in the business to support its financing as an alternative to seeking a loan for the Dawu group, a reasonable form of investment it would seem. However, the local government sent the police to arrest Sun Dawu and three other people, in the meantime challenging the local Procuratorate (a

government department with powers similar to the courts and the police, which has the right to arrest policemen and government officials when they are caught taking bribes or acting illegally) and accusing them of illegally withdrawing public deposits. In Sun Dawu's case, the state holds the power and does not provide freedoms for private enterprise. In addition, officials also used their monopoly to seize Sun Dawu's rent. All these actions hinder the enthusiasm and economic development of private enterprise and therefore it is clear that state power has an important effect on social and economic processes. From the theory of the State, it is learned that the existence of a state is essential for economic growth. The government serves as an agent of the state organs. The government specifies and enforces property rights on behalf of the state and therefore it has to be responsible for the state's economic growth or decline. It plays a vital role in the economic reforms and institution changes. "Property owners are dependent both upon society and its police power to protect their property rights and upon the law to adjudicate disputes of which there are many" (Gordon, 1980: 213). Over the last 30 years of China's economic reforms, there have been two forces acting in this development: one is the spontaneous action from the endogen of nongovernmental force—the reforms from the bottom up; and the other is the drive from the government—top-down reforms, but confined to economic reforms. Generally speaking, the government played an important role in the whole course of China's reforms, though its reforms originated with the nongovernmental contracting of land in rural areas.

When reforms in urban areas were implemented, top-down mandatory reforms in particular were adopted with the government as the major sponsor. Governmental sub-divisions adopted a series of effective measures to carry out reforms using the superiority of their political position and the allocation of resources at their disposal. They provided a favourable institutional environment for the new institution to come into being, which promoted the growth of the market and the formation of market mechanisms (Lin, 1997). This mode of institution changes with the government guiding the process ensured some achievements in China's economic reforms. As the

government has so far shown no sign of carrying out political reform, obvious compromises can be found in the economic reforms due to their incompleteness. Confronted with this dilemma of the present reforms, then, greater attention has to be paid to the government's guidance and power and reform of the government itself—its political reforms.

CHAPTER THREE

Research Methodology¹²

3.1. The Research Process

Research is a term loosely used in everyday speech to describe a multitude of activities, such as the collection of masses of information, delving into esoteric theories, and producing wonderful new products (Nicholas, 2001). This thesis focuses on both economic and social research methods, for instance, positive analysis, qualitative and quantitative research and the case method. In order to maintain a clear focus and direction throughout the course of this study, it was necessary to consider its planning and justifications for research. Hague and Jackson (1998) recommend a research process which can be divided into five main elements as shown in figure 3.1. This research process was chosen as it seemed to take the most logical form and was clear to follow.

Figure 3.1. Elements of the Research Process

Set Objectives
Planning
Data Collection
Data Analysis
Report Findings

Source from: Hague and Jackson, 1998: 8.

Hague and Jackson (1998) suggest that the starting point of any research project is to

¹² Hall (1996: 29) claims “it is helpful to distinguish initially between methodology as the philosophy or general principles behind research, and methods as the practice of research and terms of strategies and techniques.”

define its objectives. Therefore, the first stage of the research process requires the setting of well-defined and clear objectives. This thesis takes the incidents of Yang Rong and Sun Dawu as two cases and at the beginning set objectives which stemmed from the subject of China's institutional change since its opening-up and reform and the issues this had brought up, such as property rights, government intervention and how to solve these. After that, the planning stage involves selecting typical cases to illustrate these issues. The incidents concerning Yang Rong and Sun Dawu were chosen because, on the one hand, these were two of the biggest private enterprises in China and many other enterprises had encountered the same situation as these. On the other hand, the time these events occurred was very close to the time of the author's research. Key players in these case studies were interviewed and data was collected and analysed through using quantitative and qualitative analysis. Finally, the author obtained his findings, which included what lessons could be learned from the two case studies.

3.2. Primary and Secondary Research

Primary and secondary research is very important to the research process. The primary data is original data generated by new research using techniques such as surveys, interviews or observations (Finn; Elliott and Walton, 2000). Hakim (1982) describes secondary data analysis as any further analysis of an existing dataset which presents interpretations, conclusions, or knowledge additional to, or different from, those presented in the first report on the inquiry as a whole and its main results. The primary research could be conducted after the secondary research with the purpose of addressing a research topic in question and collection of original data for the particular project (Malhotra and Birks, 2003). For ensuring that the primary data of the Yang Rong and Sun Dawu case study was original data, the author mainly used techniques of surveys and interviews directly and indirectly, but telephone and e-mail was also used. The author used not only primary data, but also secondary data too. This secondary data mainly came from media communication and if there was some

doubt about the authenticity of the data, the author was able to meet interviewees or interview them by phone to make sure that certain facts were true. For example, it was reported that when Sun Dawu was arrested by the police, he had been abused and was forced to admit that he was guilty in jail but when asked by the media, Mr. Sun said this was not the truth and that he had in fact been forced to make a false confession.

In approaching this study the author has been mindful that there are a multiplicity of research approaches that could be adopted, including:

Economic research methods:

- Positive analysis
- Normative analysis

Social research methods:

- Quantitative analysis
- Qualitative analysis
- Case study
- Interviews

These approaches include a combination of economic and social research methodologies.

3.3. Positive Analysis and Normative Analysis

Positive analysis puts aside the value judgment of the social economic activities when it analyses economic problems and establish economic theories. It focuses only on the interrelations between various economic phenomena in the course of economic activities. It analyses and predicates the results of people's economic activities through creative hypothesis and careful verification, working on such hypotheses during verification before hypotheses related to economic activities are advanced

(Zhou, 2002). Normative analysis formulates the codes of behaviour with the judgment of value as its starting point and basis, according to which it deals with economic problems, initiates economic policies, probes the methods of analysis and study so as to be in accordance with the code. Ekelund and Tollison (2000) claims normative analysis entails value judgments about what should or ought to be. It (normative analysis) has to do with behavioural norms and implies something deserves to happen, and always includes “ought” or “should” in it (Collinge and Ayers, 2000).

This thesis combines positive and normative analysis. It illustrates problems with positive analysis and indicates attitudes and values with normative analysis. The reasons are: firstly, regarding what it is and what should be, and facts and values, are intertwined. Hence, when the thesis states the facts of the CCP’s existing political system, historical review or the result of its reform and opening up to the outside world, and the harm as well due to there being no change to the CCP’s political institution, these facts also becomes mingled with the author’s feelings and comments. Secondly, to clarifying the latter will help the people involved to understand each other. For example, when it enumerates the Chinese rapid economic growth, which was built on the “the curse of the latecomer”, using an excessive amount of or even a waste of resources, the author displayed his attitude clearly: that the CCP’s policies have crippled China’s economic reform because it has kept a one party dictatorship, has safeguarded its interests group and thus wasted many limited resources. Thirdly, the description of the facts logically comes before the formation of the values. Thus, during more than half a century of the CCP’s rule, the description of facts such as the CCP’s contemporary status or history, the result of its reform and opening up, and the first-hand information obtained from interview material are very important work. Fourthly, though first impressions of this type of research may deem it as meddling, it is advocated in order to pursue the purity of positive analysis and so as to minimize interference. A lot of data analysis figures (24 tables and graphs), facts, events and cases (like the Incident concerning Yang Rong and Sun Dawu) indicate that positive

analysis is a main research method. In addition, there is no unbridgeable gap between positive and normative analysis. The description of the facts should and have to be transferred to how it can be so, for what we face is choosing an approach to achieve the goal. We have to have a norm before we can make the choice. Finally, it is undesirable to clean out value orientation or ideology in economic analysis and to attack dichotomization of positive analysis and normative analysis, because these are complementary with each other. Therefore this explains why the thesis does two things: explains and analyzes the various economic phenomena, economic problems and political systems of China since the CCP has held power, especially since it started its reform and opening up to the outside world in 1979, and also shows the different opinions and judgments of value according to a contradiction between economic problems, economic growth, economic policies and the political system of the CCP since its reform and opening up.

Positive analysis can influence moral judgments and normative analysis can colour judgments of positive questions (Sayer, 1995). Economists in their professional capacity combine the positive and normative together and there is not much distinction between them (Livesey, 1987). Therefore, the middle way of combining them together seems to be the goal we are seeking. Every theory has their potential value judgments. As the positivist, Friedman (1968) points out when discussing politics, economists are not only economists but also human, therefore, undoubtedly, their judgment will influence their economics. There has never been unbiased research, and there can't be. Our value orientation determines our solutions to problems, determines the meaning of the conception, the choice of models and observations.¹³ For example, some people are supportive of a negative relationship between democracy and development (Sirowy and Inkeles, 1991). Others feel that the idea that democracy might protect property rights is far-fetched or that it is not known whether democracy fosters or hinders economic growth (Przeworski and Limongi,

¹³ Cited from Steven R. Hickerson (1987), *Instrumental Valuation: The Normative Compass of Institutional Economics*, JEL. Sept. 1987, *Journal of Economic Issues* 21 (September): 1117-43, Hutchison. Also see Gunnar Myrdal, "Development and Underdevelopment", *Notional Bank of Egypt*, 1956.

1993). Sah (1991) even claims that authoritarian regimes exhibit a larger variance in economic performance than democracies. However, the author holds that a democratic mechanism is more apt to develop a country's economy and democracy can bring more credit, affection and commitment from the people. Everybody can realize his purpose, dream and pursue his own interests in his own way in a free and democratic State. The existence of democratic institutions allows governments chosen by a majority vote to be more efficient and more just. They can accelerate fair competition and liberate the development of a market economy.

3.4. Qualitative and Quantitative Method

All research is either qualitative or quantitative (David, 2004: 44). "There two general methodological approaches in the social sciences: quantitative and qualitative" (Miller and Brewer, 2003: 192). A qualitative approach is one in which the inquirer often makes knowledge claims based primarily on constructivist perspectives (i.e. the multiple meanings of individual experiences, meanings that are socially and historically constructed, with an intent of developing a theory or pattern) or advocacy/participatory perspectives (i.e. political, issue-oriented, collaborative, or change-oriented) or both. "A quantitative approach is one in which the investigator primarily uses post-positivist claims for developing knowledge (i.e. cause and effect thinking, reduction of specific variables and hypotheses and questions, use of measurement and observation, and the test of theories) and collects data on predetermined instruments that yield statistical data" (Creswell, 2003: 18). The two approaches could be combined so as to maximize the strengths and minimize the weaknesses of each method.

This thesis adopted a large amount of data through interviews and document research and also depended on the case studies of Yang Rong and Sun Dawu. The two cases focus on obvious issues: why Yang Rong's property rights were removed and why Sun Dawu could not obtain a loan from Chinese banks and was put into jail. The

author focused on these issues to specify the strategy of inquiry, collecting and analyzing data, and presenting the results. In addition, some economic quantifiable data and statistical analysis is used, for example, when proving that a great deal of national assets were slackening and not used efficiently, quantitative analysis of the proportion of property rights structural change of the Chinese industrial economy over the past 50 years was carried out. When the author analyzed the data of the change in the structure of all industrial property rights, it was identified that one of the key measures in economic reform is the reform of the structure of the property rights and the role of the government in economic development. In this thesis, this analysis depends on a deep familiarization with a normal or typical real-life situation that is happening in present-day China since the CCP come to power in 1949 and its reform and opening up to the outside world in 1978. It aims to discover how the Chinese and others understand the situation of political systems affecting the development of a country's economy by investigation and analysis. It also seeks to develop knowledge by linking the accounts of political and economic theories. This study involves a significant number of variables and constants in the political and economic situations and the problems of contemporary China under the CCP's rule. Data is from some aggregation, average and range, and even comparison, because it considers that the true information is blocked or some false evidence is given in China, which got the results for demand of the research.

3.5. The Case Method

A case study may be defined as “an empirical inquiry that investigates a contemporary phenomenon within its real-life context when the boundaries between phenomenon and context are not clearly evident, and in which multiple sources of evidence are used” (Miller and Brewer, 2003: 22 and Yin, 1989: 23). Yin (1994) suggests that the case study method is best applied to contemporary events by methods that are naturalistic in form (that is, when gathering data in a natural setting or via relatively open-ended interviews or observation techniques). Case studies may involve a range

of methods, a range of purposes and a range of sampling techniques (Yin and Robert. 1994: 1). As Schramm (1972) defines, “the essence of a case, the central tendency among all types of case study, is that it tries to illuminate a decision or set of decisions: why they were taken, how they were implemented, and with what result.”¹⁴ The concern about case studies is the lack of rigour of case study research; there is little basis for scientific generalization; they take a long time and result in massive, unreadable documents. Case studies can be found in economics, in which the structure of the economy of a city may be investigated by using the case study method (Yin, 2003).

Burns (2000: 460-461) suggests that the purpose of the case study is:

- they are very valuable as preliminaries to major investigations;
- observation case studies may have the aim of probing deeply;
- a case study may refute a universal generalization;
- a case study may provide anecdotal evidence illustrating more general findings;
- a case study may be valuable in its own right as a unique case;
- a case study is preferred when the relevant behaviours cannot be manipulated.

Case study research includes single- and multiple-case studies that are in reality but two variants of case study designs. One rationale for selecting a single-case is it represents the critical test of a significant theory; an extreme case or unique case; the revelatory case, and is the representative or typical case. Single cases are a common design for doing case studies, which use holistic designs and embedded units of analysis (Yin, 2003). In multiple-case studies, the evidence from multiple cases is considered more compelling and robust. “The rationale for multiple-case designs derives directly from your understanding of literal and theoretical replications” (Yin, 2003: 52).

Yin (2003) claims that there are six sources of evidence: documentation, archival

¹⁴ Schramm, W. (1972, December), *Notes on case studies of instructional media projects*. Working paper for the Academy for Education Development, Washington, Chicago.

records, interviews, direct observations, participant observation and physical artifacts. Burns (2000) suggests that the sources of evidence are: documents, interviews, participant and non-participant observation and artifacts.

The selection of cases for research is intimately bound up with the nature of the topic the researcher wants to do and the question of access. The selection of cases depends on the chosen topic but the topic can sometimes be changed to fit the case as well (David, 2004). Brewer (2000: 76) refers to Stake's (1998: 88-9) suggestion that there are three types of case selection:

- Intrinsic cases are selected and studied for their own sake, without the intention to generalize from the results.
- Instrumental cases are selected to represent a set of similar settings. It is believed that it is possible to generalize from the findings of such cases.
- Collective cases are selections from different settings designed to allow comparison.

In this thesis, the incidents concerning Yong Rong and Sun Dawu are used as two case studies and the case study method is used to analyze these events, in which Hua Chen and Sun Dawu themselves are quite typical. It involves not only the definition of property rights, state and government role, but the long talked-about primitive accumulation of private entrepreneurs' capital in mainland China as well. And last but not the least it involves the power of governments' operations and administrative laws and regulation. If justice is done in these cases, it will lead the way in furthering not only the development of private enterprises and providing financial assistance, but also it will help implement institutional change and path dependence in mainland China. This thesis probes deeply into the importance of property rights and State power through the investigation of subjects in the incidence of Yang Rong and Sun Dawu, and provides anecdotal evidence of examples and more general findings. For example, it is impossible to solve the crux of the matter regarding property rights if the existing Chinese political system is not changed. It is impossible to develop the economy if the property rights cannot be protected in the economic activities of

contemporary China.

3.6. Interviews

The interview is an alternative method of collecting survey data, whereby interviewers ask questions orally and record the respondents' answers, and the typical way in which this is done is through a face-to-face encounter (Babbie, 2003). Interviews are widely used and abused research methods, which generate data through asking people to show and express their own thoughts in their words or their everyday lives (Miller and Brewer, 2003). Interviewing is a widely-used technique and is a way of obtaining information from one or several individuals which is not reliant on the subjects' self-reports (Grosf and Sardy, 1985). Interviewing involves asking people questions and it is an equal partnership between interviewers and respondents. The qualitative (or in-depth) interview can take many forms such as face-to-face, telephone or by computer (David, 2004). Interview techniques can use the face-to-face technique or telephone (Reaves, 1992). In interviews, the researcher conducts face-to-face interviews with participants, interviews participants by telephone, or engages in focus group interviews with six or eight interviewees in each group. "These interviews involve unstructured and generally open-ended question that are few in number and intended to elicit views and opinions from the participants" (Creswell John W, 2003:188). Interviews can be constructed along a continuum of formality, which can be described as: at one extreme there is the completely formal interview where the interviewer behaves as much like a machine as possible, and at the other end there is the completely informal interview in which the shape is determined by the individual respondents. With this in mind a semi-structured approach to the interviews was employed with each interviewee being asked the same questions but given considerable latitude when it came to answering in order to allow the interviewee to bring up other issues or areas of concern. The results of these interviews can be taken as the starting point for giving an insight into the culture of organization and enterprise. Interviewing as a technique is clearly open to bias and it

is very difficult to eliminate it completely; but one should be aware of the problem.

In relation to the case studies of Yang Rong and Sun Dawu, the former is relevant to the protection of property rights and the role of the State, and the latter is relevant to government monopoly which led to rent-seeking activities and showed how defective laws are harmful to economic development. The cases of Yang Rong and Sun Dawu are typical because they are not only two of the biggest private enterprises in China but there is similarity in their cases with other enterprises and the issues presented are also found in 8 - 15 per cent of all the enterprises in China each year.¹⁵ In these two case studies, there are four sources of evidence: documentation, archival records, interviews, media communication. (Both interviews adopted two methods of questioning, semi-structured and in-depth, and these were according to the actual situation, for example, almost all of the interviewees were able to express their ideas in their own words, and could avoid answering any question if they wished to) . These case studies involve not only the definition of property rights, government intervention and monopoly but also the long talked-about primitive accumulation of private entrepreneurs' capital and lawful maturity in mainland China as well. And last but not the least; it involves power of governments' operations and administrative laws and regulation.

The Yong Rong case study will take four groups as objects of study:

- Former high-ranking officials who were discharged for opposing the suppression of students in the 1989 Democracy Movement, or supported political reforms. Some of these officials have been in jail before for these reasons;

¹⁵ *Duowei Times*. 29, March, 2005 (Chinese Edition). *China Finance*. 30, September, 2006 (Chinese Edition), *China news Website*. 06, November, 2005 (Chinese Edition).

- Dissidents, the majority of whom have been in prison before, and some people who have been sentenced to 20 years' imprisonment for asking the CCP to become democratic and abandon dictatorship;
- Government servants and top managers who are working now or have done work in relation with Yang Rong;
- Vulnerable and persecuted groups who come to the capital city for appeal from various classes throughout the country because they suffered unfair treatment and persecution due to the local officials' corruption.

The Dawu case study will take five groups as objects of study:

- Present heads or directors of local banks that have participated in the investigation of Dawu.
- Dissidents who hold different points of view about the social problems in present-day China.
- The top managers who are working now or have done work related to Dawu;
- Professors or economists who are working in universities or institutes.
- Counsellors-at-law, journalists and scholars.

The types of interview were chosen because they can help gather valid and reliable data, which is relevant to the research questions and objectives. However, different types of interview are available and a choice must be made as to the most suitable to employ. Interview methods vary generally along a continuum, depending on how much freedom the interviewer has in asking questions, and include structured and unstructured interviews, the former involving questions to be asked in a certain order and the latter giving more freedom (Reaves, 1992).

In this research, the author selected the interviewees because their views hold considerable weight for the following reasons:

1. Experience of the cases, for example senior managers and other parties involved.

They have personal feelings and experiences because they experienced all or part of the events.

2. Experts and scholars who have been working in fields relevant to the author's research. They collected data in this area, and were concerned with similar issues for many years, so they have authority and credibility.

3. Journalists and consultants who have been concerned with similar events, as well as having extensive contacts with such cases. Their views do not stop at the theoretical level but involve practice.

4. Dissidents who have engaged in democratic activities in China. Many of them have not only suffered long-term imprisonment, but have also even had their families broken up. So they have their own unique insight into and personal experience of the conflict between Chinese dictatorship and democracy.

5. Current government officials. As a member of the system of the Chinese Communist Party they can more clearly understand current communist government policies, and can help the author to understand not only the trends of policies but also the abuse of policy.

6. Officials who have lost their position. The reason that they left their jobs is because most of these people supported the political and economic reforms, and asked the Chinese Communist Party to abandon autocratic rule. Some were purged and others even put in the jail. They have personal experience of the drawbacks of the old system and had sufficient reason to request the CCP to abandon one-party rule and take the road of democracy and law.

7. Petitioners. They are from all over the country and they have experienced different problems stemming from the incompatible contradictions between different geographical districts and the Chinese Communist regime. This effect of the stagnant system is not only obstructing social development but also harming the people.

In addition, the author also considers other qualifications when selecting the

interviewees, relating mainly to four factors. Firstly, their occupation is relevant to the author's research fields, or they are parties who worked or consulted for the enterprises and have inside information. Secondly, the interviewee's work and life experiences are close to the author's topic or at least in the same research direction. Thirdly, some interviewees have both their own views and universal views. Finally, the interviewees were willing to be interviewed by the author.

Interviews were conducted mainly face to face because it can be clearer and direct. At the same time, if the circumstances necessitated or there was a need to supplement the content of the original interview, then interviews were also conducted via network Video chat, e-mail and telephone etc. At the same time, interview places were: the interviewees' home or office, or restaurants, cafes, tea bars, cars, even streets and so on. Also the key issues and content were designed according to the occupation and qualifications of the interviewees and parties once the interview had been arranged. Before starting each interview, the author established a rapport with interviewee by explaining the nature of the research and its part in his studies on the political and economic topic. Each interviewee was given reassurance that their anonymity and that of their place of work and home address would be preserved. The interview process lasted nearly three years on and off because in contemporary China this task is very dangerous not only to the author but also to interviewees. In the meanwhile, the author had to use anonymity in this thesis in order to protect interviewees and keep the author's promises made at the time because most of them would not like to show their name in order to avoid trouble not only for themselves but also for their family.

For the list of interviews concerning the Hua Chen Group see Appendix I

For the list of interviews concerning the Dawu Group see Appendix II

CHAPTER FOUR

A CRITIQUE OF THE CHINESE COMMUNIST PARTY REGIME AND A RATIONALE FOR POLITICAL CHANGE

4.1. Introduction

According to the theory of contract in its simpler form, the citizen is tied to the governing authority first, because he, in common with all other citizens, has made a contract with a person or body of persons, under which that person or body receives the authority in return for the protection and service of declaring and enforcing a system of legal rules, and secondly, because he and his fellows are bound by natural law to respect and perform the terms of that contract (Barker, 1976: 188). This theory shows that if any form of government breaks the contract, for example, if the CCP cannot abide by the theory of contract to secure the Chinese people's rights of safety, life, liberty, and the pursuit of happiness, it is the right of the people to alter or to abolish their government and to install a new government. If any form of government puts people under absolute despotism, it is their right and duty to overthrow such a government in order to provide new guards for their future security.¹⁶ A state must be founded on and act in accordance with this contract in order to protect citizens' profits and to preserve benefits and keep all aspects of society in balance. If this balance is broken, the government and system must be changed, leaving the state intact and preserved. But the property rights which emerge are a result of an on-going tension between the desires of the rules of the state, and the efforts of the parties in their exchanges, in order to reduce transaction costs. It is impossible to develop a useful analysis of the state if it is divorced from property rights because the essence of property rights is the right to exclude. Efficient property rights should be competitive and exclusive. Therefore, property rights must be specifically defined.

¹⁶ The Declaration of Independence, American Memory Collection, Library of Congress, July 4, 1776; also see Declaration of the Rights of Man and the Citizen, August 1789; and Universal Declaration of Human Rights, December 1948.

Institutions are the humanly devised constraints that shape human interaction and institutional change shapes the way societies evolve through time. Institutions govern the performance of an economy, and it is this that gives the ‘new institution economics’ its importance for economists (Menard, 2000). Although the institution is stable, its supply and demand are in balance. Institutional changes will occur when the existing institution fails to satisfy people’s demands. Since the whole country has been controlled under the rule of the CCP since 1949, even Chinese life has not been ensured, let alone any “demands”. But when the CCP was compelled to reform China and open up to the outside world, demands not only included a substantial life for people but also a spiritual life such as democracy, liberty and human rights. The lack of these had accumulated rancour for many years, and with protesting breaking out in various quarters, the conflict between these demands and the tyrannical institutions was soon revealed. China is a highly centralized country and the political system will play a key role, thus the political system is the master of social and economic development. It is impossible to avoid the tremendous impact of the political system on the development of the economy and society. Sustained economic growth requires some formal institutional arrangements that limit the power of the state; that is, some form of checks and balances (Menard, 2000).

The lessons of Eastern Europe and the previous Soviet Union showed us that “communism collapsed because of its own failures rather than because of the much-proclaimed victory of the west” (Wallis, 1994: 27). Their failure, first of all, was a failure of their political systems. These systems were short of necessary rules and a legal system, democracy and fair-minded public opinion monitoring programme, and lacked free, fair and equal competition. The Chinese Communist Regime had to change their economic system through the political system and imported capitalism in part, privatizing and denationalizing public enterprises in order to develop a social economy. This was in order to save itself and delay an imminent change in its regime and economy as was seen in the collapse of the former Soviet Union. However, this reform led to a tremendous social effect in that China is now developing rapidly,

having been likened to a huge dragon flying swiftly upward. However, despite this rapid development, only a few people's potential has been unleashed due to their creativity, enthusiasm, vitality, work and passion limited and restricted by the political system of the Chinese Communist Regime. Thus, the Regime must be completely changed without preconditions. Of course, superstructure and consciousness have a huge reacting force on the economy, but although the present economic situation of China is developing quickly, appearances can be deceptive and it is unreliable to trust this initial impression. "Throughout history, political thinkers have tried to provide a key to unlock the mysteries of the world of politics and to bring into sharp focus the reality underlying the appearance" (Geraint, 1991: 1). Many social problems are in fact getting worse rather than benefiting from the increasing economy.

That most basic virtues of civility, responsibility, justice, integrity of traditional cultures and moral outlook, which regulate human behaviour and maintain the social order and have been passed down from one generation to another for thousands of years seem to be collapsing. The Chinese appear to be losing the ethics rooted in personal commitment, social purpose, and spiritual meaning. The social crises that Chinese people worry about are many: violent crime, an unstable economy, competition with other countries such as countries of the European Union, the US, Japan and others, unemployment, spiralling health care costs, family instability, drugs, AIDS, failing education, a lack of affordable housing, disintegrating cities, hunger and homelessness, as well as other factors. "Our public life reflects our moral values, one way or the other. We've all seen how politics can reflect our worst values of selfishness, greed, divisiveness, fear and power...Our times cry out for a new political morality, one that will provide the ground for new possibilities" (Wallis, 1994: 16). Most of the present social problems in China have been caused by the political system, which is controlled by a dictatorial regime and has led to political corruption, a polarity between the rich and poor and an imbalance in social benefits for people. According to Menard (2000), corruption should be considered as systemic and deliberate: it is the natural result of efficient predatory behaviour in a lawless world.

“The powers of political parties, bureaucratic organizations, corporations and networks of corporatist influence are among a variety of forces which put pressure on the range and scope of decisions that can be made within a nation-state” (Held, 1991: 212). This chapter will examine how the existing political institution affects economic development and why China’s contemporary political system has to be changed, through analyzing the status and side-effects of the political, economic and social environment when the political and economic reforms are not synchronous. In the meanwhile, interviewees’ commentaries will further strengthen these results and viewpoints, because these interviewees are not only from different social, professional and educational groups, and have differing political aims and economic interests, but also much key information and data. All of the above points of view will be proved through an analysis of history and today, and from China to world in order to make known that today’s China still need completely changed, which is the dialectics of nature and natural law. As Roach (2006) pointed out, the economics and politics of China are on a dangerous collision course.

4.2. Historical Review

4.2.1. Politics Determined Everything in 1949 - 1978

The Communists disdain to conceal their views and aims. They openly declare that their ends can be attained only by the forcible overthrowing of all existing social conditions. Let the ruling classes tremble at a communist revolution. The proletarians have nothing to lose but their chains. They have a world to win.

Working men of all countries, unite!

Manifesto of the Communist Party: IV. Position of the Communists in Relation to the Various Existing Opposition Parties (Marx, Karl and Engels, Frederick (1846) *The Communist Manifesto*. Harmondsworth: Penguin. 1976.)

Violence is the main means by which the Communist Party gained power. This

character trait of the CCP may be unavoidable when attempting to gain political power. It was unimaginable that the CCP would use violence repetitively during its peaceful periods and to maintain its ruling in China. The CCP used violence as a sole means to solve all its issues. For example, the suppressions of the Hu Feng¹⁷ Anti-Party Group and the Anti-Rightists Movement eliminated the intellectuals; killing the Christians, Taoists, Buddhists and popular organised groups solved the problem of religions; mass murders during the Cultural Revolution established to maintain the CCP's absolute leadership; the Tiananmen Square massacre was used to prevent political crisis and repress democratic demands. In the words of Adam Smith (1775), "socialism is not only by far the most important species of collectivism or "planning"; but that it is socialism which has persuaded liberal-minded people to submit once more to that regimentation of economic life which they had overthrown because it puts governments in a position where to support themselves they are obliged to be oppressive and tyrannical"¹⁸ These actions were all necessary for the CCP under the leadership of Mao Zedong¹⁹ to strengthen its power and maintain its rule in the face of continual financial crisis, political crisis and the crisis of belief. Socialism is a system of social organization in which property and the distribution of income are subject to social control rather than individual determination or market forces.²⁰ In the beginning, authoritarian ideas could be put into practice only by a strong dictatorial government. To them, socialism meant a deliberate reorganisation of society on hierarchical lines, and freedom of thought was regarded as the root-evil of

¹⁷ Hu Feng (1903-1985) a scholar and literary critic, was opposed to the doctrinarian literature policy of the CCP. In 1955, Hu Feng expresses his opposition to what he saw as the sterile literature policy of the Party and the Party sentenced him to 14 years in prison. He became mentally ill in prison, was only rehabilitated and released in 1980, and subsequently resumed his activities in the literary world until his death (Hu, 1991; <http://mclc.osu.edu/rc/pubs/institutions/denton.htm>).

¹⁸ Quoted in Dugald Stewart's Memoir of Adam Smith from a memorandum written by Smith in 1755. pp.25

¹⁹ Mao Zedong or Mao Tse-tung (1893—1976). He was the founder of the People's Republic of China. From 1928 until 1931, Mao, with other comrades, established rural strongholds and built the Red Army in the Jinggangshan. During the Second Sino-Japanese War (1937--45), Mao lived in Yan'an in Shanxi province. After a civil war of three years (1946-49), Mao kicked Chiang Kai-shek out of mainland China and established the People's Republic of China. Mao then launched a series of movements such as the anti-rightist movement (1957), the Great Leap Forward (1958), and the Cultural Revolution (1966-1976). These programs were a failure and many people died (Tian, 2004).

²⁰ www.britannica.com/eb/article-9109587/socialism

nineteenth-century society, to be “treated as cattle” (Hayek, 1944).

The Crackdown on Counter-revolutionaries (1950-1953)

In March 1950, the CCP announced “Orders to Strictly Suppress Reactionary Elements,” which is historically known as the movement of “suppression of the reactionaries.” The CCP started its brutal suppression of counter-revolutionaries which included religion and the complete ban of all grass-roots religious groups (1950-1953). Thousands of landlords, rich farmers, reactionaries, the special agents of the KMT, and Christians, Catholics, Taoists, and Buddhists were killed.²¹ In reality, a huge amount of wealth and land were obtained by the brutal suppression against the landowners and rich farmers (Eberhard, 1977). As Hayek (1944) points out, the great majority is rarely capable of thinking independently, and on most questions they accept views which they find ready-made. In any society, freedom of thought will probably be of direct significance only for a small minority. So when the CCP makes its decisions, no one is allowed to dissent or disagree. By the end of 1952, the CCP-published number of the executed “reactionary elements” was about 2.4 million. But actually, it was more than this figure. This campaign in the countryside was also accompanied in 1951 and 1952 by the Three Anti and Five Anti Movements in cities. The former was directed ostensibly as “anti-corruption, anti-waste and anti-bureaucrats, mainly to corruption”.²²

The Three Anti and the Five Anti Movements (1951-1952)

The “Three Anti Campaign” began in December 1951 and targeted corruption, waste

²¹ After that the CCP instructed its local governments to ban all unofficial religious faiths and secret societies and Christians, Catholics, Taoists, and Buddhists were put under government surveillance (Zhang, 1997).

²² After the report from the northwest bureau, which disclosed some party members’ corrupt and wasteful behaviour, drew attention from the central party in November 1951, the CCP initiated this movement (Wu, 1999).

and bureaucracy among the CCP cadres. Some corrupt CCP officials were executed. The Five Anti Movement was “anti-tax evasion, anti-bribery, anti-cheating in government contracts, anti-thefts of economic intelligence, and anti-stealing of state assets.” “The aim was to get control of the factories and squeeze capital out of the capitalists. Many were eliminated in an atmosphere of terror, and some were left to function as government employees” (Goldman, 1999: 349).

In the course of these movements, the number of people affected by the various punitive or reform campaigns was estimated in the millions. According to *Facts of the Political Campaigns after the Founding of the People's Republic of China*, co-edited by four government units including the CCP History Research Centre in 1996, during the “Three Anti Campaign” and “Five Anti Campaign,” more than 323,100 people were arrested and over 280 committed suicide or disappeared. In the “Anti-Hu Fang campaign” in 1955, over 5000 people were incriminated, over 500 people were arrested, over 60 people committed suicide, and 12 people died from unnatural causes. In the subsequent suppression of the reactionaries, over 21,300 people were executed, and over 4,300 committed suicide or disappeared.²³

The Transition to Socialism (1954-1957)

This action was the main work of Communist China's First Five-Year Plan (1953-57). In Agriculture Reform, the CCP imposed a number of practices on farmers such as mutual-aid groups, primary cooperatives, advanced cooperatives, and people's communes. Peasants were asked to “dash” into socialism at high speed. As Smith (1776) points out, if anyone should attempt to direct private people in what manner they ought to employ their capitals, he will load himself with most unnecessary attention and also overstep his authority. It is so dangerous when a man who has folly

²³ Data from the excerpt of the book published by the Hong Kong based *Chengming* magazine (www.chengmingmag.com), October issue, 1996.

and presumption enough to fancy him fit to exercise it.

The CCP established a residential registration system in order to prevent peasants from going to the cities to live and find work. In the Reforms in Industry and Commerce, all assets of capitalists and business owners were purchased, merged with or forced to cooperate with the CCP. In the handicraft industry, all handicraftsmen had to join the cooperative that was organized by the CCP. This period is still regarded as having been enormously successful for the CCP because it completely eliminated private ownership in China. A strong central government had been built.

Serious policy issues and problems appeared, such as the number of landlords increasing, rich peasants being killed and some capitalists committing suicide by jumping from the tops of buildings. But preliminary collectivization was 90 per cent completed by the end of 1956. In addition, the government nationalized banking, industry, and trade. Private enterprise in mainland China was virtually abolished. The CCP political centralization was consolidated and private ownership completely eliminated in China as well. In this sense, socialism means the abolition of private enterprise, of private ownership, of the means of production, and the creation of a system of “planned economy” in which the entrepreneur working for profit is replaced by a central planning body (Hayek, 1944:24).

The Anti-Rightist Movement (1957-1959)

In July 1957, a slogan of “letting a hundred flowers blossom and a hundred schools of thought contend” (sometimes called the Double Hundred Campaign) was advanced by Mao Zedong.²⁴ Mao called upon the Chinese intellectuals and other people to “help the CCP rectify itself.” At that time, there were many times more than 10,000 workers’ and students’ strikes, and much agitation about peasants asking for

²⁴ In 1956, a group of Hungarian intellectuals formed the Petofi Circle, which held forums and debates critical of the Hungarian government. The group sparked a nationwide revolution in Hungary, which was crushed by Soviet soldiers. Mao Zedong was afraid that a “Hungarian Event” would happen in China (Tian, 2004).

withdrawal (Wen, 2001). Intellectuals, sensitive to the change of the current political situation and presenting active ideology and criticism on dogmatism, delivered their different opinions on culture, education, and science among other areas. Some even criticized the party and the government's defects, errors and their cadre style in public. Some comments were very severe, and some were wrong. To these new contradictions, some communists and cadres without preparation in thought fell into a passive state. As Henry Bracton (1951) points out, "for that is an absolute villainage from which an uncertain and indeterminate service is rendered, where it cannot be known in the evening what service is to be rendered in the morning, that is where a person is bound to whatever is enjoined to him."²⁵

Unfortunately, the CCP treated these new problems in an old way, with the trouble caused by the masses and severe comments treated as class struggle, and attempted to suppress them by simple and crude means. Soon the CCP initiated an "anti-rightist" movement, declaring 550,000 of the people who dared to speak up as "Rightists." Over three million were labelled as "medium rightists" or "anti-CCP anti-socialist elements" (Hu, 1991:486). Fairbank (1992:407) claims that 500,000 or more persons were labelled "Rightists" in 1957-58 and several million in the countryside named "antisocialist elements". The penalties included loss of jobs, informal criticism, "re-education through labour" and in some cases execution, and tens of thousands of people lost their freedom, with millions of families suffering.

The Great Leap Forward (1958-1960)

In May 1958, the second session of the Eighth National Congress in Beijing was convened. The National People's Congress announced the "Great Leap Forward" and its policies spread out across the whole country. The main aim was to pursue the high

²⁵ The quotation from Henry Bracton, which is borrowed from M. Polanyi, *The Logic of Liberty* [London, 1951]), p.158. (449)

speed production and construction of industry and agriculture continuously and to greatly improve and revise the plan index (Bloodworth, 1980). The movement called for a massive increase in steel production and electrical and coal output. The goal was to surpass British and American industrial output by 1972. Policies such as “achieving a grain production of 75,000 kg per hectare”, “doubling steel production”, and “surpassing Britain in 10 years and the US in 15 years” were attempted year after year. This blind act violated economic discipline and not only led to a waste of manpower and material resources, but also caused a severe maladjustment in the national economy. These policies resulted in a grave, nationwide famine that cost millions of lives. Edema occurred in many places due to malnutrition, and the death toll increased in the countryside of many provinces (Hsu, 1981: 435).

Due to the decrease in the birth rate in many places and obvious increase in the death toll, the population was 10 million less than in 1960 according to the official statistics.²⁶ The original hope that people could be given a better life as quickly as possible had resulted in this tragic situation. This was the severest outcome and lesson of the Great Leap Forward and the People’s Communes.²⁷ According to Goldman and Fairbank (1999), in the period spanning 1958 - 1960 some 20 to 30 million people lost their lives through malnutrition and famine because of the policies imposed upon them by the Chinese Communist Party. As Gernet (1982: 667) points out, the catastrophic harvests aggravated the consequences of errors committed during the Great Leap Forward, causing it to fail.

Shortly after the Great Leap Forward, China’s Great Famine occurred, and resulted in the highest death toll. “The number of unnatural deaths and reduced births from 1959

²⁶ The CCP had to acknowledge that “the party and the people faced the most serious economic difficulty after the founding of the People’s Republic of China.” So the textbooks of the CCP had to admit that “the great leap forward and the people’s commune were a severe misplay in the course of the CCP’s exploration to the way of socialist construction. The reasons for economic difficulty were natural disaster and mainly work’s error. In some places the reasons stemmed 30% from natural disaster and 70% from human error” (Hu, 1991:457 -- 500).

²⁷ People’s communes were formerly the highest of three administrative levels in rural areas in the period from 1958 to around 1982 in the People’s Republic of China. The communes had governmental, political, and economic functions. They were the largest collective units and were further divided into production brigades and production teams. After 1982, they were replaced by townships (Zhang, 1997).

to 1961 is estimated at about 40 million...China's depopulation by 40 million is likely to be the world's greatest famine in this century."²⁸ Amartya Sen (1989 and elsewhere) famously argues that democracies do not experience famines because formal checks on government behaviour make it more costly for government officials to make large policy errors at the expense of unrepresented individuals. Implicitly, then, formal institutions embodying some form of checks and balances offer an advantage over other institutional arrangements for minimizing arbitrary state action (Menard, 2000: 98).

The Great Proletarian Cultural Revolution (1966-1976)

The development of the CCP has seen the following successive steps: government by regional party groups (1949-52); the party as a national bureaucracy (1952-58); the party as direct manager of the nation as a total entity (1958-61); and finally, the party slowly removing itself from various governmental functions after 1961²⁹ so it has enough political power to do what the CCP want to do. The cultural revolution was an appellation of that time. In fact it was not a revolution at all, but a civil strife which blocked the country's socialist development. The so-called "Great Revolution" was launched and led by Mao Zedong. The aim was to prevent the restoration of capitalism, maintain the purity of the party and seek a socialist road with Chinese characteristics (Huang, 2001). But according to Gernet (1982: 674), "the Cultural Revolution was not simply an operation designed to allow Mao Zedong to regain power, it was accompanied by a vast movement of political justification".

²⁸ The article "Great Famine" from *Historical Records of the People's Republic of China*, the Red Flag Publishing House, February 1994. The quote was translated by the translator. Also see Adshead (2000:332), "an absolute reduction of 18 million of urban population in the twenty years from 1959 to 1979", and also Peter Worsley, *Inside China* (Allen Lane, London 1975) p. 187.

²⁹ J.M. Lindebeck, in *Soviet and Chinese Communism: Similarities and Differences*, Donald Trwagold, ed. (Seattle: University of Washington Press, 1967), pp. 99-100.

Mao Zedong believed revisionism had appeared in the centre of the CCP party and that the party and the state were facing the danger of a restoration of capitalism,³⁰ and so only the Great Cultural Revolution could win back the rights deprived by the so-called “Zouzipai”³¹ by publicly mobilizing people across the country. Hookham (1969) argues that Mao's aim was to eliminate the “four olds”: old ideas, old habits, old customs, old culture; and old foreign influences as well. To this Great Revolution was added “culture”, because this movement began from the field of culture.³² And Mao also said that a “cultural revolution” was essentially a “political revolution” (Wen, 2001). In this movement, many innocent supporters and ordinary people were framed and prosecuted as counter-revolutionaries in a number of wrong and misjudged cases led by the Red Guards.³³ The Red Guards became a staple of Chinese life. Innumerable historical museums, historical relic, historical documents, vestiges of cultural heritage, ancient books, buildings and art works were destroyed by the Red Guards. They fervently sought out party officials and teachers in order to denounce them as counter-revolutionaries as well. “The formation of the Red Guards played a key role in the course of the Cultural Revolution” (Ebrey, 1981: 392) and “during the course of the ‘Cultural Revolution’ numerous cultural treasures of China were destroyed” (Eberhard, 1977). The great Cultural Revolution was no revolution and social progress, but a civil turmoil launched mistakenly by leaders and made use of by anti-revolution group, causing severe catastrophe to the party, the country and all

³⁰ The central political bureau expansion meeting in May 1966 and the Eleventh Plenum of the 8th Central Committee were the mark of the Great Cultural Revolution. In the two meetings, the central CCP's note and the central party's decision on the proletariat Great Cultural Revolution were passed, and the CCP made an adjustment to the central leading organization, forming a deviation from the left in ruling state in the Great Culture Revolution (Tian, 2004).

³¹ Zouzipai means the ruling capitalists or their representatives in the Communist Party of China (Zhang, 1997).

³² On 10th November 1965, the newspaper *Wenhuibao* in Shanghai published an article commenting on Hairui's dismissal from office, which helped trigger the Great Cultural Revolution. Hairui was an officer of the Ming Dynasty (1368—1644 AD) and was dismissed from office for his honesty (Hu, 1991).

³³ The Red Guards refer to civilians who were the frontline implementers of the Great Cultural Revolution. Most Red Guards were youngsters in their mid-teens summoned by Chairman Mao Zedong to protect the forward progression of the Chinese Communist Party against “evil forces” such as imperialism and corruption, including those within the Communist Party who were identified as deviants (Tian, 2004).

ethnic people.

The Cultural Revolution pushed the CCP and Mao Zedong's cult of personality to a climax. Mao's theory had to be used to dictate everything and one person's vision had to be embedded in tens of millions of people's minds. The Cultural Revolution not only exterminated ancient Chinese civilization, spirit, historical sites, moral character and traditional modes of thought but also decimated the Chinese Communist Party as well as the economy of China. During the ten years of the Cultural Revolution, the whole society had no order and law and everything was chaos. That there is some order, consistency and constancy in social life is obvious. If there were not, no-one would be able to go about their affairs or satisfy the most elementary needs. Stebbing (1933) claims that when we know how a set of elements is ordered we have a basis for inference. Order is most apparent where man has been at work.³⁴

The Great Proletarian Cultural Revolution started in 1966 and ended in 1976 when Mao died. Conservative figures place the number of unnatural deaths during the Cultural Revolution at 7.73 million (Hu, 1991: 609). "Estimates of victims of the Cultural Revolution now hover around a million, of whom a considerable number did not survive"(Goldman, 1999: 402). At least 3 million officers were wrongly judged and 300,000 others wrongly convicted of crimes during the Cultural Revolution (Fairbank, 1992:407). This very serious chaotic situation was halted tentatively when the "Gang of Four"³⁵ was arrested after Mao died in 1976 and came to a complete end

³⁴ See L.S. Stebbing, *A Modern Introduction to Logic* (London, 1933), p.228-229. Also, see E.E. Evans-Pritchard, *Social Anthropology* (London, 1951), p.49 and also *ibid.*, p.19: It is evident that there must be uniformities and regularities in social life, that society must have some sort of order, or its members could not live together.

³⁵ The "Gang of Four" was formed by Mao Zedong's wife Jiang Qing (1913-1991), Shanghai Propaganda Department official Zhang Chunqiao (1917-1991), literary critic Yao Wenyuan (1931) and Shanghai security guard Wang Hongwen (1935-1992). They rose to power during the Great Cultural Revolution (1966-1976) and dominated Chinese politics during the early 1970s. The CCP attribute most of its faults and blame to the "Gang of Four".

when the third Plenum of the 11th Central Committee of the CCP convened in December 1978.

4.2.2. The So-Called “Bringing Order Out of Chaos” and Taking the Planned Economy as the Mainstay and Market Regulation as a Supplement from 1978 - 1987

The Third Plenum of the 11th Central Committee of the Communist Party of China was held in December 1978 in Beijing. Before the formal meetings, at a working-group session, the newly empowered party boss, Deng Xiaoping, ³⁶gave a speech that turned out to be the most important one in modern Chinese history. He urged that the CPC Central Committee has to shift the focus of work to socialist modernization of strategic decision making to determine internal development and enliven the economy, opening up policy. The ratio of the national economy must be vigorously adjusted, there must be reform of the old economic system, so that economic development has a new outlook. The plenum profoundly reviewed the lessons drawn from the “Cultural Revolution”, and broke down the long-standing shackles of the “Left’s” erroneous ideology. This central committee discussed in-depth the transition of the CCP’s work, and determinedly shifted the focus of the work of the Party and the State towards a socialist modernization drive, implementing the reform and opening-up strategic decisions. The whole Central Committee admitted that it was time to shift the emphasis in the Party’s work towards constructing socialist modernization. The measures completed a great turning point of far-reaching significance in the history of the Party since the founding of Communist China.³⁷

³⁶ Deng Xiaoping (1905-1997: One of the old guard of the Chinese Communist Party, becoming China's paramount leader from 1978. From then on, Deng Xiaoping made a series of reforming and opening policies to develop the economy in order to save the rule of CCP. Deng ordered using force the tanks and bayonet to end the student demonstrations in the Tiananmen Square in 1989. Deng died from Parkinson's disease in 1997 at the age of 93. (<http://www.cbw.com/asm/xpdeng/contents.html>).

³⁷ Deng Xiaoping's important speech, titled “Emancipating the Mind, Seeking Truth from Facts and Uniting as One Looking Forward to the Future”, made at the Central Committee's Working Conference held before the Third

Although the democracy that the CCP promised was not enforced, economic policies were spread little by little throughout the country. As a whole, this Central Committee took a deciding step towards an essential reform of the economic and political systems under the premise of adherence to socialism. The CCP adopted economic reform policies aimed at expanding rural incomes and incentives, encouraging experiments in enterprise autonomy, reducing central planning, and establishing direct foreign investment in China.³⁸ The CCP ended the debate about whether or not the market economy had to be rooted in capitalist ideas. “It is wrong to maintain that a market economy exists only in capitalist society and that there is only “capitalist” market economy. Why can’t we develop a market economy under socialism? Developing a market economy does not mean practising capitalism. While maintaining a planned economy³⁹ as the mainstay of our economic system, we are also introducing a market economy. But it is a socialist market economy ... We cannot say that market economy exists only under capitalism. Market economy was in its embryonic stages as early as feudal society. We can surely develop it under socialism”⁴⁰. After 1979, the CCP moved towards more pragmatic positions in almost all fields but every policy had to follow the “four cardinal principles”,⁴¹ which were regarded as the unshakable foundation for building up the country. Reform began in the field of agriculture first. In a rural district, peasant autonomy was honoured and a system of responsibility was introduced. Peasants were allowed to farm the lands

Plenary Session, was a declaration of the new theory on building socialism with Chinese characteristics (Deng, Xiaoping, 1993).

³⁸ There was a big guideline in Deng Xiaoping’s statement. He said: “I believe some areas, some enterprises and some workers and farmers can be allowed to be rich and get a better life in advance with their industrious endeavour for high salary (Deng Xiaoping 1993: 213).

³⁹ Hayek, F. A. (1944: 80) claims, “Once government has embarked upon planning for the sake of justice, it cannot refuse responsibility for anybody’s fate or position. In a planned society, we shall all know that we are better or worse off than others, not because of circumstances which nobody controls, and which it is impossible to foresee with certainty, but because some the authority wills it.”

⁴⁰ Uphold the Cardinal Principles, Deng Xiaoping, 26 November 1979, quoted from Deng Xiaoping (1993).

⁴¹ The four cardinal principles were: Marxism-Leninism and Mao Zedong Thought, CCP rule, dictatorship of the proletariat, and socialist road. This was advanced by Deng Xiaoping’s speech on the Party’s theoretical work in March 1979 (Deng, Xiaoping 1993).

freely, and given government contracts.⁴² This gave many peasants an incentive to produce, and consequently the output in 1984 exceeded 400 tons. Eventually, Mao's "People's Commune"⁴³ was dissolved, and a more capitalist attitude took place in the countryside. The reform of the primary economic system showed outstanding progress in the countryside. In May 1980, Deng Xiaoping gave a speech on countryside policy, where he stated that after relaxing the countryside policies, forming a production contract with peasants in the proper areas resulted in a good outcome and rapid change. Due to the peasants' motivation and creativity, some new management systems formed from the people's communes gradually broke through, and all kinds of agriculture production responsibility systems rapidly developed. Through the intervention of the CCP, at the start of 1983, 93 per cent of production teams in the countryside had realized production contracts with peasants and had work contracted to households, most of which had household contract responsibility systems⁴⁴.

"Although the planned economy continued to play a role in the major industries, market forces were to guide the urban economy as they were guiding the rural economy. Soon thereafter, the urban reform set in motion a new economic surge" (Fairbank, 1992: 413). Since the start of reform, the economic system developed rapidly throughout the country. The characteristics are as follows: countryside

⁴² As Hayek (1944: 56) suggests, "the state should confine itself to establishing rules applying to general types of situations, and should allow the individuals freedom in everything which depends on the circumstances of time and place, because only the individuals concerned in each instance can fully know these circumstances and adapt their actions to them."

⁴³ People's communes (or Renmin Gongshe), were formerly the highest of three administrative levels in rural areas in the period from 1958 to around 1982 in the People's Republic of China. The communes had governmental, political, and economic functions. They were the largest collective units and were further divided into production brigades and production teams. After 1982, they were replaced by townships (Wu, 1999).

⁴⁴The household contract responsibility system: or the rural families' all-round responsibility system, all collective lands were contracted to the family in the countryside. Agriculture production basically was became to make their own management decisions and take full responsibility for their own profits and lose. They could get the rest after the production to the state and the collective. This responsibility enable peasants to get the self-run right of production and distribution combining the peasants' obligation, rights and interests, which overcome the disadvantages of management centralization and singleness of work mode (Wu, 1999).

restructuring is further deepened on the basis of consolidation, stressing city reform and city economic reform, and economy reforms in city develop fully. Reforms in other fields also had an important step. The main task of countryside restructuring was consolidated and household contract management developed. As Minami (1994) points out, after 1978 there was a gradual transition and farmers were free to decide what to produce on their family plots. Turning to the sources of growth since 1978, during the first reform phase (1978-83) almost half the acceleration in the growth rate was due to agriculture. Standards of living improved through the reform and transition of the economy, shown in Figure 4.2.3.1. below. During the three-year period from 1979 to 1982, the average annual growth rate of agricultural output was 7.5 per cent whereas during the 29-year period from 1953 to 1982, the average annual growth rate of agricultural output was 3.8 per cent. The average annual growth rate of staple necessities such as tea, meat such as pork, beef, and mutton, cotton, sugar cane, oil-bearing crops and sugar beet were all above 10 per cent.

Figure 4.2.3.1. Growth of Chinese Agricultural Output Value, 1952-82

Growth of Chinese Agricultural Output Value, 1952-82 (unit: Wandun)					
				Avg. Annual % Increase	
	1982 as % of 1952	1982 as % of 1978	1982 as % of 1981	1953-82	1979-82
Gross agricultural output	306.6	133.5	111.0	+3.8	+7.5
Grain output	215.6	116.0	108.7	+2.6	+3.8
Cotton output	275.9	166.0	121.3	+3.4	+13.5
Output of oil-bearing crops	281.8	226.5	115.8	+3.5	+22.7
Sugar cane output	518.3	174.7	124.3	+5.6	+15.0
Sugar beet output	1,401.3	248.4	105.5	+9.2	+25.5
Tea output	484.1	148.2	116.0	+5.4	+10.3
Fruit output	315.7	117.4	98.9	+3.9	+4.1
Pork, beef, and mutton output	399.1	157.8	107.1	+4.7	+12.1
Output of aquatic products	309.0	110.7	111.9	+3.8	+2.6

Source: Statistical Yearbook of China 1983 (Hong Kong: Economic Information Agency, 1983), p.10.

When the CCP started to see success and benefits from its reform and transformation of the economy, especially in agriculture in the countryside, the CCP determinedly further accelerated and deepened the reforms. A decision on the reform of the economy was passed at the Third Plenum of the 12th Central Committee of the Communist Party of China in October 1984. This decision summarized the experience of the economic reform since the founding of Communist China, especially since the Third Plenum of the Eleventh Central Committee in 1978. A series of important problems concerning the reform of the economy were raised and analyzed. It was a document outlining a fervent creed for carrying out thorough reform of the economy. The most important part of the decision was that differences between the planned economy and commercial economy were removed. Socialist economy is commercial economy on the basis of public ownership. This is present basic theory and practice during economy reform. Decisions centred on this basic root, the main problem should be solved in building active socialist economy and economy system reform especially in city spread in full swing.⁴⁵ Clear progress was achieved by 1987.

The Chinese economy developed well in the years after The Third Plenum of the 12th Central Committee of the Communist Party of China. The Gross output value of industry and agriculture increased to 1.335 trillion yuan in 1985 from 770.7 billion yuan in 1980, with an annual growth of 11 per cent according to set prices in 1980. GNP increased from 447 billion yuan to 856.8 billion yuan in the same period, with an annual growth of 10 per cent, exceeding the planned yearly growth rate of 4-5 per cent. The income and consumption rates in both urban and rural areas also increased remarkably. The average consumption rate per capita across the country increased from 227 yuan in 1980 to 406 yuan in 1985, with an annual growth of 8.7 per cent

⁴⁵ Chen Kang (1995: 108) argues, "Urban reform has brought to people new risks and costs such as fluctuating prices and income. It has not brought about new options and opportunities. Opening up the labour market will give people more opportunities and win over support."

after the deduction of inflation, which was much higher than the average yearly increase of 2.6 per cent from 1953 to 1980.⁴⁶ This developing situation lasted up until the 13th CCP National Congress of the Communist Party of China was convened in October 1987.

4.3. The Revelation from the Revolutions of the Former Soviet Union and Eastern Central Europe at the End of the 20th Century

4.3.1. Introduction

From 1989 to 1991, the former Soviet Union and Eastern Europe were characterized by turbulence and turmoil. But then changes in the political scene took a sudden turn and developed rapidly, to the amazement of the world. In just two years, socialist countries such as Poland, Hungary, the German Democratic Republic (GDR), Czechoslovakia, Bulgaria, Romania, Yugoslavia, Albania and the Union of Soviet Socialist Republics (USSR) all saw the power of their States change hands. One after another the Communist Parties, or Labour Parties in Office, were forced to relinquish power as a “domino effect” occurred. With the loss of the Communist Parties’ political status, the social systems in Eastern European communist countries saw the most radical change.

The world knows that in Eastern Europe and the Soviet Union communism collapsed in 1989-1991 and these events are termed as “revolutions”. It is believed that the main causes of revolutions stem from economic problems, but, in fact, revolutions are large-scale social experiments that include a number of other causes, in particular, political reasons that have a large influence and even, to some extent, play the key role under specified conditions. Just as mentioned by Batt (1991: 72), “All past attempts at economic reform in Eastern Central Europe failed primarily because of the

⁴⁶ Unless otherwise specified, statistics reported in this thesis are drawn or derived from various volumes of the Statistical Yearbook of China (State Statistical Bureau, Chinese edition).

political obstacles posed by the communist parties' monopoly of political power" and led to a series of disadvantageous serious consequences. For example, state control of the economy affected the flexibility of central planning, because economical planning requires accurate information. Without accurate information planners could not make decisions that met needs and were efficient and the planners had to accommodate the demands made upon them by party leaders so it was impossible to adapt quickly to unforeseen problems (Henderson and Robinson, 1997: 17). The purpose of this chapter is to discuss the tremendous impact of the political system on the economic and social development in Eastern Central Europe (ECE) and the Soviet Union and why the political system had to be completely changed in ECE and the USSR, inspiration for this study as well. What occurred in the former Soviet Union and Eastern Central Europe in 1989, was in effect, a revolution, which indicates that the communist institution violates social development, human nature and the order of nature, and that it will be defeated sooner or later, and will happen in other socialist countries as well as China. Without question, at that time, the economy of the former Soviet Union and Eastern Central Europe was stronger than other socialist countries such as China, Vietnam and North Korea. The former Soviet Union and Eastern Central Europe is much closer geographically to western democratic countries and it was easier for them to be influenced by democratic and liberal thought, and so their politics are more matured than the socialist countries of the Far East. The contradictions of Chinese society have intensified and accumulated over a long period of time, such as movement of enclosures, corruption, unemployment issues, price inflation and social insurance problems as well as many other problems. Perhaps Chinese people will eventually form a revolution as has been seen in the former Soviet Union and Eastern Central Europe, changing the CCP's tyrannical institution when they cannot endure it anymore. Any small event has the potential to trigger a revolution, such as the Gdansk incident of Poland in 1980 (<http://www.moreorless.au.com/heroes/walesa.html>).

What Happened in Eastern Central Europe and the Soviet Union in 1989-1991?

The Soviet Union was the first socialist country in the world after the October Revolution in 1917. It is not known what would have happened and how communism would have worked out if there had been no World War II, but unfortunately, Hitler “helped” Marxism to be propagated owing to the launch of the war. The Red Army occupied Eastern Europe in the name of liberation and to drive Fascism out and helped Eastern European communist parties build and consolidate their regimes. From then on, the two great camps began to enter into rivalry. Poland, Hungary, the GDR, Czechoslovakia, Bulgaria, Romania, Yugoslavia, Albania all had the Soviet Union’s system imposed on them in the four years after the end of the Second World War, which included the same governing ideology, governmental institutions, and economic, legal, and social systems. Although each country soon began to shape its imposed superstructure in its own image, certain similarities continued to persist. The eight countries form reliable premises for comparison, as do the effects of the different regimes which ruled over them, although societal reactions to the superstructure and to those imposing it differed markedly throughout the region. Eastern European countries copied the political and economic models according to the Soviet Union after they built their own socialist system but the basis of the Stalinist system was a central planning agency staffed by a bureaucracy that grew inexorably. This central planning agency ultimately controlled everything including the operation of every factory or enterprise in the economy. In addition, Soviet models were formed under a special wartime situation that made it uncertain whether it would fit for the USSR itself after the war had ended, let alone the ECE. “The type of radical change all these countries were to experience was, however, hardly suitable in terms of their histories, predilections, aspirations or needs” (Brown, 1988: 4). The social evils inherent in communism gradually became visible after practice and various kinds of reforms in Eastern European countries should not be avoided.

4.3.2. Varieties of Reform

In Eastern European countries, most assets were owned by the State and, in reality, the

State bureaucracy. Almost all enterprises and companies are owned by the State. Ownership is highly relevant because in those countries, the lack of real owners caused many problems. There was no control and no motivation to try to make the most of the assets one had. State enterprises and companies ran inefficiently because nobody cared and was concerned about their operation. Leaders and managers were appointed by a state bureaucrat, and the state bureaucrat was not interested in finding the right person to run the company in the best way because the bureaucrat was not interested in the profit made by the company but in appointing someone from a select small circle from whom he could get back reciprocal favours in due course. Leaders and managers in turn used the power of patronage for their own personal benefit. Patronage moves in a virtuous spiral for its beneficiaries and a vicious spiral for society as a whole. Bureaucrats gradually formed a group and oligarchy - a group who govern such a state. A group such as this controls everything but does not solve any real social problems, such as employment, rising living standards, crime and so forth, and in the meanwhile, they are interested only in serving their own purposes against parliament and against democracy as well. In these countries, the bureaucrats controlled all the economic, political, social, and cultural institutions, resources, and interactions. They co-opted large numbers of activists and experts, and began to build up a large quasi-constituency of people who began to realize that they might profit modestly from the existing system. "In this situation, the over-centralized and despotic rules exercised by the party leadership become anachronistic" (Prins, 1990: 31). As a result of these factors, it is inevitable that reform would begin as people became unable to bear everything in front of them. People expressed their dissatisfaction through extreme behaviour. For example, "in Hungary, the suicide rate was in the low 20 per 100,000 in 1948. It was 45 per 100,000 by 1984. Alcohol consumption followed a similar path, from 4.9 litres per capita per annum in 1950 to 11.7 in 1984" (Prins, 1990: 20).

In fact, demands for reform began to occur from the early 1950s with a series of events including:

1. In the GDR, the Berlin upheaval of 17 June 1953.
2. In Poland, the Poznan uprising of 28 June and the October Event of 1956 and the Gdansk wave of strikes from 17 to 18 December 1970, and 1976, 1980-81 as well.
3. In Hungary, the Budapest revolt of October 1956.
4. In Czechoslovakia, the Prague Spring of August 1968.

But all these reform movements were crushed by the Soviet Union's military force or other members of the Warsaw Pact - these "counter-revolutionary actions" were never allowed in the eyes of the Communist Parties. But although these attempts at reform were quashed, a common demand for progress and reform in the economic and political fields persisted, with a desire for democracy and liberty. Normally these movements were peaceful and at the beginning occurred individually in one place at a time, "but it also quickly became a national movement against the ruling regime with the aim, not specifically of toppling it, but of extracting far-reaching concessions from it. But the concessions demanded became such that no regime could agree to them and remain communist" (Brown, 1988: 10). So it was inevitable that a new movement should emerge, with the first significant changes beginning in Poland in the 1980s and, ironically, in the first and biggest socialist country - the USSR in 1985, led by Mikhail Gorbachev, General Secretary of the Communist Party of the Soviet Union (CPSU). From 1980 to 1991, a series of reforms began in Poland and spread through the Soviet Union. These happened for several reasons, with the main one the increasing pace of economic failure. It was aggravated by a long-term policy that catered for the present at the expense of the future. This was as true in the wrecking of the natural environment as in the wrecking of the economy and has in the event led to a major disaster for the whole of the State and its socialist ideology. Recent cross-country evidence of the relationships of institutions and economic growth suggest that institutional change is the core of economic development policy (Menard, 2000).

4.3.3. The Result of the Reform

Gorbachev's reform was so deep and comprehensive that despite the class struggle or the Brezhnev doctrine of limited sovereignty, Communism came to an end in the Soviet Union and Eastern Europe. From 1988 to 1989, Gorbachev shaped the three interrelated processes that made up the endgame of Soviet power: "the CPSU became more and more marginalized as a political force; republican legislatures fell under the sway of national democratic opposition forces, who pressed first for state sovereignty and then for independence; and power at the centre became vested increasingly in state institutions (rather than the CPSU)...." (Henderson and Robinson, 1997: 100). Gorbachev did not follow his predecessors and refused to resort to tanks or troops as the ultimate way to deal with political argument and "to encourage the communist governments to use force against mass expressions of civic disobedience" (Tismaneanu, 1999:9). In the meantime, Gorbachev actively promoted his political theory, the New Thinking that advocated multi-party politics, a pluralist system, social democracy, open and multi-candidate election, leading towards humanity and democracy.

What was clear in 1989 was that the communist system could not be reformed. Its ideology could not be reformed. There was no real democratic election and no person had ever been elected to a leading post within it. People in power were always appointed and this was the system of election "by acclaim", and the secret of the power nomenclature that lay in this system was that it was a self-appointed, self-assigned power. No-one discussed this. It did not appear in any of the discussions about abolishing the leading role of the Communist Party. The collapse of communism in the former Soviet Union and Eastern Europe has shown China and all communist countries that Eastern Europe needed a revolution to cope with these problems and as "the revolution involves simultaneously building liberal democracy and a market economy, as such it is unprecedented" (Brown, 1994: 1). That is to say, reform cannot solve all crises and problems. These crises were not only external but also arose internally and so radical change was needed. The result of the reform in both the Soviet Union and Eastern European countries was failure completely due to

the communist system, because it “proved to be unable to implement the ideas of and values of... freedom, democracy, justice, human rights, equality before the law, equal opportunities for every member of society, and freedom of thought and opinion” (Brown, 1991: 43). Communism had failed in precisely those areas where its founders said it could best succeed.

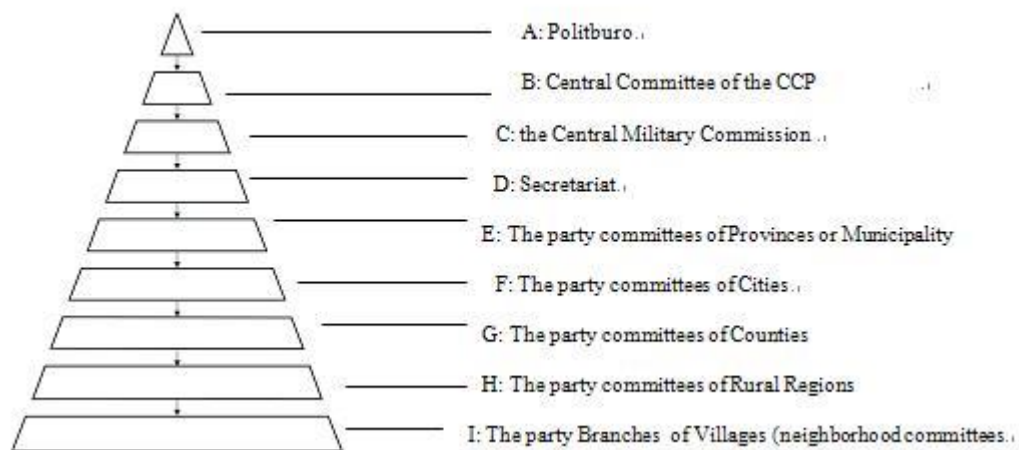
4.4. The Political Status Quo of the CCP in Contemporary China

When the CCP founded the “The People’s Republic of China”, as a socialist country, everything came under the leadership of the CCP. Everybody had to belong to a unit, which provided a life-time job, housing, health care, pension, and other welfare benefits, and through these means, the CCP managed to intervene in every aspect of people's lives, and working unit had ultimate control over the well-being of its members. “After gaining power communist parties consolidate their rule chiefly by eliminating their political opposition and by establishing a governmental structure which carries out their orders” (Gripp, 1993: 40-41). According to the “Constitution of the People’s Republic of China”, the Chinese people took state power into their own hands and became masters of the country in 1949, with the socialist system being the basic system of the “People’s Republic of China”. The constitution is the State’s radical law and the People’s Congress is China’s political system.

According to the “Constitution of the People’s Republic of China,” China’s political institutions of the CCP in contemporary China are composed of two systems: one is the party’s system and the other is the administrative (government) system. The administrative management systems are subject to the party management system. The main functions of the party are to establish the political-governmental structures for the society and to make both foreign and domestic policies, and oversee their execution. All the important decisions made by the government systems have to be controlled and approved by the party. Key to the Chinese Communist Party’s longevity has been its power over personnel appointments and in promoting hierarchical control via vertical administration to ensure party members and those officials follow the wishes of

central leadership and do not become centrifugal forces (Yang, 2004). The typical party organization is like a pyramid structure from the top down (see figure 4.4.1).

Figure 4.4.1. the Party's System:



A: Politburo (including the General Secretary and 4-8 members of the standing committee)

B: Central Committee of the CCP

C: The Central Military Commission

D: Secretariat

E: The Party Committees of Provinces or Municipality directly under the Central Government

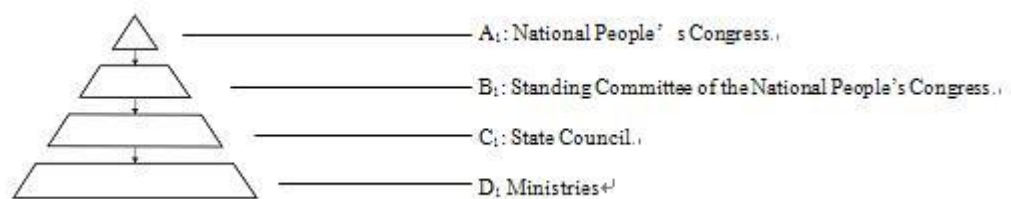
F: The Party Committees of Cities

G: The Party Committees of Counties

H: The Party Committees of Rural Regions

I: The Party Branches of Villages (neighbourhood committees)

Figure 4.4.2a. Government (Administrative) System:



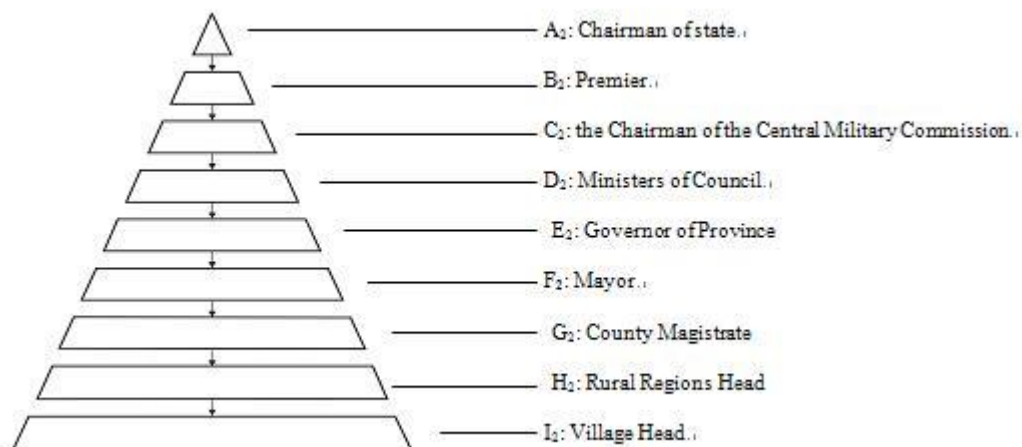
A₁: National People's Congress ⁴⁷

B₁: Standing Committee of the National People's Congress

C₁: State Council

D₁: Ministries

Figure 4.4.2b. Government (Administrative) System:



⁴⁷ The National People's Congress, which regularly holds an annual plenary session, and is elected for a term of five years. Delegates are elected according to their present administrative regions through "universal suffrage" but the candidate is named by the CCP. So the national congress was called "Rubber Stamp" merely for show.

A₂: Chairman of State⁴⁸ - President (that is assumed by the General Secretary of the CCP)

B₂: Premier⁴⁹ (that is assumed by the Politburo member of the central committee of the CCP)

C₂: Chairman of the Central Military Commission⁵⁰ (that is assumed by the General Secretary of the CCP)

D₂: Ministers of Council (that is assumed by the Vice-Secretary of the Ministries of the CCP)

E₂: Governor of Province (this position is assumed by the Vice-Secretary Province Committee the CCP)

F₂: Mayor (this position is assumed by the Vice-Secretary Mayor Committee of the CCP)

G₂: County Magistrate (this position is assumed by the Vice-Secretary County Committee of the CCP)

H₂: Rural Regions Head (this position is assumed by the Vice-Secretary Town Committee of the CCP)

I₂: Village Head (this position is assumed by the Vice-Secretary Village Committee of the CCP)

Members of the CCP hold all the key positions in government and regional or local

⁴⁸ Chairman of State. This position must be hold by the General Secretary of the CCP, in the meanwhile should be chairman of the Central Military Commission as well in order maintain the CCP political power by violent suppression at all times and in all places.

⁴⁹ State Council, i.e. the Central people's Government. It is the executive organ of the supreme organ of state power and the state's supreme administrative organ. Although according to the constitution, the premier is decided by the National People's Congress in effect, appointed and removed by Chairman of state (i.e. General Secretary of the CCP).

⁵⁰ The Central Military Commission of China that is the supreme military leading organ, leading and commanding the country's armed forces. The chairman of the Central Military Commission is held by the General Secretary of the CCP, which called the CCP leads everything. And all the officers must be the members of the CCP.

party committees supervise all regional and local governments. The party leadership and the CCP have control over all trades and professions in society and determine all policies and decisions. Although the CCP has relaxed some economic regulations since its reform and opening up, these policies have no legal protection and guarantee and once the interests of the CCP are affected, then the CCP will use its political power to change it, for example, in the cases of Yang Rong and Sun Dawu's incidents. The party committees and branches are not only set up in cities and villages but also in both national and private factories, companies, universities and schools. The party committees and branches are also not only established within government organizations but also non-government organizations. From the political system of the CCP, it is easy to see that the CCP's policies and decisions are carried out by each subordinate echelon of the apparatus through the CCP hierarchy and that the whole country is controlled from top to bottom in a smooth and expeditious manner. In 2005, there were 70 million members of the CCP in China. Communist parties function primarily as organs of political control: "Governmental structures and functions in communist systems follow the purpose, goals and procedures of their guiding communist parties.... The role of governments is to carry out the managerial assignments given to them by the party. As the controller of the communist political system the party employs the governmental apparatus as its agent" (Gripp, 1993: 57-61).

Apart from the central state institutions mentioned above, the CCP controls everything through the party organizations which penetrate all levels of the government. There are basic CCP organizations in every single village, town, and neighbourhood. The Communist Youth League (CYL), which young people over 16-years-old can join (children under 16-years-old can join the Communist Young Pioneer), contains auxiliary staff members of the CCP. The CYL is present everywhere in China, in cities, countryside, universities, schools, enterprises, government organizations and non-government organizations.

The CCP founded the Chinese People's Political Consultative Conference (CPPCC), which showed multi-party cooperation and consultation in name but was in reality still under the leadership of the Chinese Communist Party. It consists of different political parties and groups, people's organizations and patriotic democratic personages. Its major function is to build a bridge between the CCP and different democratic parties and personages in discussing key state political principles, and participating in government affairs. The democratic parties (or non-communist parties) include: the Revolutionary Committee of the Chinese Kuomintang, the China Democratic League, the China Democratic National Construction Association, the China Association for Promoting Democracy, the Chinese Peasants and Workers Democratic Party, the China Zhi Gong Party (Public Interest Party), the Jiu San (September 3) Society, and the Taiwan Democratic Self-Government League. All the non-communist parties participate in government and political affairs just in name, but the members of parties enjoy high living standards and material benefits. In addition, the CCP founded other national organizations, such as the All-China Federation of Trade Unions, the Communist Youth League of China, the All-China Women's Federation, and the All-China Federation of Industry and Commerce, as well as others.

The top leadership is able to stay powerful despite reform and the leadership between the central government and the local government, at high and lower levels, between superiors and subordinates, must be respected with only a little bit of free space allowed for local governments to operate in the economic field. The CCP emphasizes that individuals must obey organizations, subordinates must obey superiors, the whole nation and party must obey the central leadership of the CCP, and this is the organizational principle of the CCP. "The relationship between the Communist Party and government is at the core of any Leninist political system and the Party is the organized expression of the will of society" (Schurmann, 1968: 110). The Chinese constitution recognizes the CCP as the "sole leader" of the Chinese system and leads

the work of the government. According to the Constitution, top positions in the state bureaucracy are filled by the National People's Congress, but in fact, "the political reality is that the candidates nominated or recommended by the CCP are always elected"⁵¹ (Yan, 1988). The Party's authority over the government is based primarily on its authority to appoint and promote government officials. Members of the CCP are appointed to the top positions in government organizations, and in each organization all party members are organized under a party committee in order that party leaders can control and supervise party members in the government and lead the work of the government.

"Power is never the property of an individual; it belongs to a group and remains in existence as long as the group stays together. When we say of somebody that he is 'in power' we actually refer to his being empowered by a certain number of people to act in their name" (Ashe and Alan, 1999: 79). In China, for example, the organization and members of the CCP extend everywhere and control everything, but nobody has ever seen the CCP's financial records, only financial records for the state, local governments, and enterprises. Whether in central government or village committees in rural areas, municipal officials are always ranked lower than the CCP's members and so the municipal governments have to follow instructions from the communist party committees of the same level. The expenditure of the Party is supplied by the municipal units and accounted for in the municipal system. In fact, the CCP's policies of reform and opening up since 1978 disguise a desire to maintain its group interests and totalitarian rule. The Constitution, as revised in 2004, still rigidly states that "Chinese people of various ethnicities will continue adhering to the people's democratic dictatorship and socialist path under the leadership of the Chinese Communist Party and the guidance of Marxism-Leninism, Mao Zedong's ideology, Deng Xiaoping's theory and the important thought of the 'Three Represents'..." (Communiqué of the Sixteenth CCP National Congress, 2002: 16). The CCP controls

⁵¹ Yan Jiaqi: 1988, "Separation of Party and Government Work in China as Viewed From a Comparative Angle" *Wen Wei Po* (Hong Kong), 23 March, FBIS, 14 April, 42-45.

the economy tightly, just as they control most other matters, because the economy is the life and death of the party. Any solution of economic problems should first be checked by ideology. The CCP tell the Chinese people that only the party can correctly use the force of history and make the Chinese economy strong and powerful (Gordon, 2002). Under this political system, the CCP exerts control over all its resources in various ways and no organization or mechanism, such as Law Courts, can monitor, restrain or supervise the CCP as they do not have independence from its rule. The CCP remains extremely powerful in China so that after the establishment of the CCP occupied the mainland of China and founded the People's Republic of China, the whole country went through a series of political movements such as Crack down counter-revolutionaries and Land Reform (1950-1953), The three anti and five anti movements (1951-1952), The Transition to Socialism (1954-1957), The Anti-rightist Movement (1957-1959), The Great Leap Forward (1958-1960), The Great Proletarian Cultural Revolution (1966-1976), even making Tiananmen Massacre (or Beijing Massacre) in 1989 because of under the policy of politics determining everything and everything submitting to the politics. The CCP mainly concentrates on the political and ideological leadership to the people but not developing economy. These a series of movements brought about enormous losses for the state and nation.

“Under this system, the Chinese Communist Party not only controlled the government with a tight, constant ‘police patrol’, it actually substituted itself for the government” (Lieberthal and Lampton, 1992: 65). The socialist countries are most seriously afflicted by the lack of separation between the party and government (Schurmann, 1968). The CCP’s “bureaucracy remains a major and widespread problem in the political life of the State. Its harmful manifestations include the following: standing high above the masses; abusing power; divorcing oneself from reality and the masses; spending a lot of time and effort to put up an impressive front; indulging in empty talk; sticking to a rigid way of thinking; being hidebound by convention; overstaffing administrative organs; being dilatory, inefficient and irresponsible; failing to keep one's word; circulating documents endlessly without solving problems; shifting

responsibility to others; and even assuming the airs of a mandarin, reprimanding other people at every turn, vindictively attacking others, suppressing democracy, deceiving superiors and subordinates, being arbitrary and despotic, practicing favouritism, offering bribes, participating in corrupt practices in violation of the law, and so on. Such things have reached intolerable dimensions both in our domestic affairs and in our contacts with other countries.” (This speech to an enlarged meeting of the Political Bureau of the Central Committee of the Communist Party of China was discussed and endorsed by the Political Bureau on August 31, 1980; Deng Xiaoping, Volume II, 1986: 327).

4.5. Damage of the Present Political System

4.5.1. Political Institutions Hinder Economic Development

According to Smith (1776), once the judiciary is united to the executive power, justice is scarcely possible. It is necessary that the judiciary should be separated from the executive power and as much as possible independent of that power in order to make every individual feel himself perfectly secure in the possession of every right which belongs to him. Apart from the central state institutions mentioned in chapter four, the CCP controls everything through the party organizations which penetrate all levels of the government. “Political bargaining over policy proposals for economic reform is very intense. A transformation of the economic structure involves redistributing the authority and rewards among sectors, bureaucratic agencies, and regions” (Lieberthal and Lampton, 1992: 59). There are basic CCP organizations in every single village, town, and neighbourhood. The CCP controls not only its party members and party affairs, but also those who are not members, because the entire regime must “adhere to the Party’s leadership.”⁵² In the meantime, because the CCP monopolizes all social resources, in this institutional arrangement, it would simply have rights of ownership of all real resources. The CCP controls all the regions via administrative organization

⁵² See “Communiqué of the 13th CCP National Congress of the Communist Party of China in October 1987”. And “Deng Xiaoping’s speech on the Party’s theoretical work in March 1979” (Chinese edition).

from central government to provinces, autonomous regions, counties, autonomous counties and cities; townships, ethnic townships and towns; even villages because all the administrative organizations are subordinate to the CCP's Party Committees and the citizen have no right to government.⁵³

Lei Huifang⁵⁴, a former officer of the local government of Jiang Xi province and a well-known dissident, told the media when interviewed that the CCP's organization is extremely tight and it has established a household registration system, a neighbourhood residents' committee system, and various levels of a party committee structure. Party members must swear to be loyal to the party forever when they join it at the beginning, and take part in group political studies and organizational activities. The party organizations such as Communist Party committees and branches penetrate all levels of the government in every single village, town, city and neighbourhood, from party members to non-members. The CCP's control of society is all-encompassing and their rule exercises a complete monopoly. Where modern countries are concerned, all political parties, including the party in power, can only conduct their activities within the limits prescribed by the constitution and the entire legal system; they may not overstep these limits. The state powers of the party that holds the reins of government are manifested mainly by its political leadership and by means of the implementation of the party's will and advocacy by that party's members in state organs as they handle affairs separately. They must not become directly involved in the specific work of legislation, administration, jurisprudence, and public opinion. Hence, no party members who concurrently hold major leading positions in the party in power should at the same time hold positions in the country's legislative,

⁵³ The conception that the government should be guided by majority opinion makes sense only if that opinion is independent of government. The ideals of democracy rest on the belief that the view which will direct the government emerges from an independent and spontaneous process. It requires, therefore, the existence of a large sphere independent of control in which the opinions of individuals are formed. There is widespread consensus that for this reason the case for democracy and the case for freedom of speech and discussion are inseparable. Hayek, F.A. (1960: 109).

⁵⁴ All the interviewees detail see the appendixes.

administrative, or judicial organs, or be in charge of news media. They should either be officials within the party, or officials outside the party, but not both. However, this is impossible in China because of the way the CCP is structured. Whenever we move a step forward in economic reform, we are made keenly aware of the need to change the political structure. If we fail to do that, we shall be unable to preserve the gains we have made in the economic reform and to build on them, the growth of the productive forces will be stunted and our drive for modernization will be impeded.⁵⁵ Yong Zheng, who is an economist and dissident, also holds the same view: “the household registration system is to build a harmonious society, the first major obstacle. It will be between urban and rural, between regions, between cities divided by privilege, governing and protecting the interests of some people at the expense of another part of their rights. Injustice is increasingly becoming the source of hatred, a hotbed of crime. Freedom of movement is important for the modern state’s civil rights. But the Chinese people’s right to movement is controlled. Abolition of the household registration system is necessary, replacing it with the ID card system for social management, similar to U.S. social security number, personal and family information, employment, income and property status, the credit records of law-abiding tax, pension and other medical rights and guaranteeing that the establishment of a unified national social security system; the Government should provide residents with public services, employment, education, social security and other benefits.” Xin Aoguo, the dissident and a famous scholar told the media “the theory of household registration prevails. Most countries have adopted identity management, human numbers, or social security number management and other measures; but only North Korea, Benin and China implement a household registration system these two countries are isolated with China in having a household registration system, which is something different. The United States allows freedom of movement, urban and rural integrated development, and so is more balanced; China does not allow freedom of movement, urban and rural areas are fragmented, there is urban household registration only, targeted at people so

⁵⁵ Deng Xiaoping’s speech, from a talk with Yoshikatsu Takeiri, Chairman of the Central Executive Committee of the Komei Party of Japan, on 3 September 1986 (Deng Xiaoping, 1993)

that their own development is not balanced.”

According to Olson (1971), “a class in Marxist terms consists of a large group of individuals who have a common interest arising from the fact that they do or do not own productive property or capital. As in any large, latent group, each individual in the class will find it to his advantage if all of the costs or sacrifices necessary to achieve the common goal are borne by others.” Menard (2000) pointed out that when both the formal and informal institutions exist, it is easy to produce a dictatorship without the formal institution of decentralization to limit the ability of various levels of government officials.

The Petitioner Wang Baosen knew clearly how decadent the CCP’s policies are from personal experience. When Wang Baosen exposed the corruption of the County Party Secretary, the County Party Secretary was not punished, but Wang Baosen was prosecuted by his local government because of the exposures he had made. He told the author, when the author visited his village,⁵⁶ that in today’s China, the CCP sabotaged Chinese traditional culture. Chinese people are taught by the ruling state that “all kindness starts with filial piety.” Loyalty, filial piety, dignity, honesty, shame and justice have set the social standards, and Confucius’ five cardinal virtues of benevolence, righteousness, propriety, wisdom, and faithfulness have laid the foundation for social and personal morality. But the CCP smothered all the human nature, ethics and the most fundamental human morality, behavioural norms, and standards of judging good and bad. The CCP’s officials conspire with gangs to organize crime syndicates, gambling, bribery—corruption of every kind is prevalent.

⁵⁶ Petitioner’s village: In China, a petitioner is not only a person who initiates a lawsuit, he/she also belongs to the weak group that when she/he lose a lawsuit at local court and does not have any opportunity to appeal so she/he has to go to the capital to appeal to the central government and form a special group. Petitioner’s village is located in south of Beijing city. Petitioners come from all over the country and gather in the petitioner’s village when they are prosecuted by the local government; undergo denial of justice of local court; suffer unredressed injustice because of officials’ corruption or wrongdoing. The petitioners come to the capital to appeal to the State Council and Central Government. The investigative data of the Chinese Academy of Social Sciences illustrate that only 1.6% cases can be sent to the local relevant administration department to be retried. Even in these 1.6% of cases, only 0.4% of cases can be remedied (See the Newspaper: *Nanfang Weekend*, 5 May 2007 (Chinese edition) or visit: <http://www.bokequn.cn/artical/259268.html>). Normally, 20,000 petitioners assemble in petitioners’ villages all year round waiting for the CCP’s mercifulness and conscience.

Shoddy products, prostitutes, drugs, a lack of ethics and morality are the result. The CCP is resistant to losing its power and position and have therefore united together to take more material benefits, with corruption helping to stabilize the CCP's political power. Corruption is endogenous to a political system since the regime itself is predatory.

The dissident Chen Ximing told the media that China has the world's highest administrative costs and China's number of public servants is 35.57 million people. The Corruption Perception Index (CPI) of the German global "Transparency International Organization (TIO)" stated that China's score was 3.4 points and ranked 71th in the world in 2004. In 2005, the World Economic Forum Annual Report in Davos, Switzerland officially released the Environment Sustainable Index (ESI) for the evaluation of environmental quality, which showed China ranked No.133 of 144 countries in the world. In China, the people's working time is the longest in the world - longer than South Korea and Japan - and over 600,000 people died of overwork every year. The death rate from coal extraction per million tons was 3.96 per million tons in 2004 which also was World Rank No. 1. In the United States it is 0.039 per million tons, which means that the Chinese death rate from coal mining accidents is more than 100 times that of the USA. China produced 1.66 billion tons of coal, which was 33.2% of the world *total*, *but its* mining disasters were 80% of the world total, with a death toll of 6027.

Ferejohn (1986), McCubbins et al. (1987), Shepsle and Weingast (1984)⁵⁷ point to the important role of formal institutions in insulating private citizens from arbitrary government action and political and electoral institutions, such as checks and balances between the different branches of government or the electoral rules that lead to divided governments. Government credibility is increased by making policies hard to

⁵⁷ This quotation is from Shirley, Mary (1997), The Economics and Politics of Government Ownership, Journal of International Development, 9(6), Sept-Oct 1997.

change. Institutions are the ‘set of constraints on behaviour in the form of rules and regulations’ and ‘moral, ethical and behavioural norms’ of a society (Menard, 2000).

“Corruption and profiteering of government officials also heighten the debate on the political system. The authoritarian reformers now saw a greater need for administrative reforms in the sense of establishing a professional civil service system, and separating the functions of the Party organs from governmental organs. The democratic reformers advocated a more fundamental reform of political system, with some even going so far as to demand a Western form of democracy based on a multiparty system, complete with freedom of the press” (Chen, 1995: 82).

Chen Ximing told the media that over the past few years, the communist party has been cracking down on corruption and bribery and severely punishing corrupt officials. Officials are imprisoned or even executed every day but still the situation does not change much. Even today, these actions are still characterized by political purposes. For instance, many so-called top “people’s servants” have been put into jail, including Li Jiating, the former governor of Yunnan Province; Liu Fangren, the Party Secretary of Guizhou Province; Cheng Weigao, the Party Secretary of Hebei Province; Tian Fengshan, Minister of Land and Resources; Wang Huaizhong, the Lieutenant Governor of Anhui Province and Beijing mayor and member of the Political Bureau of the CCP Central Committee for engaging in bribery and corruption. They all should be jailed, but the real crime they had undertaken was that they stood against Jiang Zemin on political issues. Only when the party separates its crackdown on corruption from politics can the elimination of corruption make real progress and the legal system become effective under the party.

“Indeed, to the high-minded who feel that the politician should concern himself exclusively with the common good the reality of constant assuaging of particular groups by throwing them titbits or more substantial gifts must appear as outright corruption” (Hayek, 1976: 10). Corrupt government is at the same time weak. Lord

Acton argues that all power tends to corrupt, and absolute power corrupts absolutely. “Corruption and governance are increasingly popular topics for analysis. In contrast to the mainstream discussion of corruption, we propose that patterns of corruption must be analysed in their political context because corruption is endogenous to the political process” (Menard, 2000: 188).

China began its economic reform and open-door policy in 1978. By October 1992, when the 14th Congress of the Chinese Communist Party formally endorsed the concept of “socialist market economy”, the Chinese economy in terms of its structure and institutional condition, was under the control of political power. The CCP’s policies of reform and opening up disguise its desire to maintain its group interest and totalitarian rule. For the CCP, power is its sole aim because power can bring many rewards.⁵⁸ But many great thinkers, from John Milton and Edmund Burke to Lord Acton and Jacob Burckhardt, have represented power as the archevil.⁵⁹

Ruan Dexin told the media that in Article 35 of the CCP’s Constitution, citizens of the People’s Republic of China have the freedom of expression, publication, assembly, association, protest, and demonstration. But nobody holds the rights of belief, speech, publication, assembly and legal defence. The CCP never approves any demonstration that is against it or that it does not need. The CCP will arrest anybody who applies to demonstrate and will put the petitioners into jail when they come to the capital city to appeal to justice. Where is the Freedom? Where is the Law? Where is the Order? All these are controlled and determined by the CCP. The culture of the CCP is an isolated

⁵⁸ Hans Kelsen, *What is Justice?* (California, 1957) p.1: Justice is primarily a possible, but not a necessary, quality of a social order regulating the mutual relations of men. Only secondarily it is a virtue of man, since a man is just, if his behaviour conforms to the norms of a social order supposed to be just....Justice is social happiness. It is happiness guaranteed by a social order (quoted from Hayek, 1976: 158).

⁵⁹ The complaints about power as the archevil are as old as political thinking. Herodotus had already made Otanes say in his famous speech on democracy that “even the best of men raised to such a position [of irresponsible power] would be bound to change for the worst” (Histories iii.80) (quoted from Hayek, 1960: 449-450).

monopoly with no freedom of thought, speech, association, or belief.

Liang Yuhui, a dissident, had been a university law lecturer but was dismissed because he appealed for the abolition of one-party dictatorship. He devoted himself to democracy activities to promote the progressive ideas of freedom and democracy, and the Chinese authorities detained him several times. He was imprisoned for 7 years for organizing the Chinese Democracy. He told the media that from 1954, namely after the CCP came to power, it formulated a residential registration system and prohibited people's freedom of movement and residence. According to the Universal Declaration of Human Rights in December 1948, everyone has the right to freedom of movement and residence within the borders of each State. From then on, this unfair system greatly restricted the free mobility of labour and human capital because it forcefully classified people into rural and non-rural populations, creating an unreasonable separation and opposition within one State. Despite recent reforms to this system, peasants still have no medical insurance, no retirement pensions and no unemployment welfare. Peasants have to pay much higher school fees for their children and a much higher price for housing than local permanent residents if they stay in the cities.

Sima Yi, a former top official of Ministry of Organization of the CCP, told the media that in China, there are 3,120 newspapers, 2,200 magazines, and 736 local TV and radio stations which are controlled absolutely by the CCP and, according to its demands, must make and transmit propaganda programmes. The CCP never permits any private media agency or organization. In addition, today the CCP employs 150,000 "cyber police" to monitor the internet and directly block any overseas websites that the CCP does approve of. Any speech and behaviour calling for democracy and liberty are regarded as a challenge to the one-party dictatorship and will be repressed. The CCP's aim is to maintain its group interest and totalitarian rule. Xin Aoguo told the media, that "since the Internet, China has been implementing the so-called Golden Shield Project – the Great Fire Wall (GFW). This project was

composed of several components to achieve different functions. The Great Firewall of China is the Chinese government's way of monitoring and filtering Internet content of software and hardware systems, from servers and routers and other equipment, plus related applications. It needs to be emphasized that, due to extensive Internet censorship in China, "inappropriate" content of websites will be subject to direct administrative intervention, they are required to conduct self-censorship, self-regulation, and even shut down, so the GFW plays a major role in the analysis and the filtering of information networks inside and outside China."

Olson (1971) argues that socialism and the growing activities of government will usually or inevitably restrict economic freedom, and perhaps threaten political rights as well. Others hold that the economic activities of the State in every way restrict "freedom", holding that freedom is essentially a political concept involving democracy and civil rights rather than economic policy.⁶⁰ Any society in which the guarantee of rights is not secured, or the separation of powers not determined, has no constitution at all.⁶¹ "Laws cannot be made except at the expense of liberty".⁶² Just as Hayek (1976:92) pointed out, "as dictators themselves have known best at all times, even the most powerful dictatorship crumbles if the support of opinion is withdrawn. This is the reason why dictators are so concerned to manipulate opinion through that control of information which is in their power."⁶³

⁶⁰ See Karl Mannheim, *Freedom, Power, and Democratic Planning* (New York: Oxford University Press, 1950), esp. pp. 41-77; Thomas Mann, "Freedom and Equality," in *Freedom, Its Meaning*, ed. Anshen, pp. 68-84; Joseph Rosenfarb, *Freedom and the Administrative State* (New York: Harper, 1948), pp. 74-84; John R. Commons, *Legal Foundations of Capitalism* (Madison: University of Wisconsin Press, 1957), pp. 10-130 (the quotation is taken from Olson, 1971: 92).

⁶¹ Declaration of the Rights of Man and the Citizen, August 1789.

⁶² See J. Bentham, "Principles of the civil code", in *Theory of Legislation*, edited by C.K. Ogden (London, 1931), p. 98 (quoted from Hayek, 1976:158).

⁶³ Hayek, F. A. (1976) explained that the preservation of a free system is so difficult precisely because it requires a constant rejection of measures which appear to be required to secure particular results, on no stronger grounds than that they conflict with a general rule, and frequently without our knowing what will be the costs of not observing the rule in the particular instance (quoted from Hayek, 1976:61).

Cao Siyuan told the author that the CCP has not dealt with issues of property rights nor understood what role governments can play on earth since it came to power in 1949. Once the CCP occupied the mainland of China, it never specified property rights in order to minimize the possibility of opportunistic behaviour but changed the structure of property rights through the means of the national regime. The root of the inefficient market results is from the inefficiency of the property rights structure. For example, before 1978, the proportion of state-owned industrial property rights in China rose from 26.3 per cent in 1949 to 89.5 per cent in 1964, while the proportion of private industrial property rights fell from 74 per cent to 11 per cent in the same period. This irrational transfer of property rights was conducted under political pressure and was certainly in violation of objective law. It led to low efficiency in economic development for several decades. Since the opening up and economic reform of China in 1978, state-owned industry fell sharply. In 1999, the state-owned economy accounted for only 28.2 per cent while the private economy accounted for 71.8 per cent in the national economy. The production value of state-owned enterprises in the same year was 3.5571 trillion Yuan (Chinese Currency name), which is far below the value from non state-owned enterprises which was 9.0539 trillion Yuan. This is a striking contrast. (See Figure 4.5.1a.and 4.5.1b.)

Figure 4.5.1a. Table of the Proportion of the Change in the Structure of Property Rights in the Chinese Industrial Economy Over the Past 50 Years

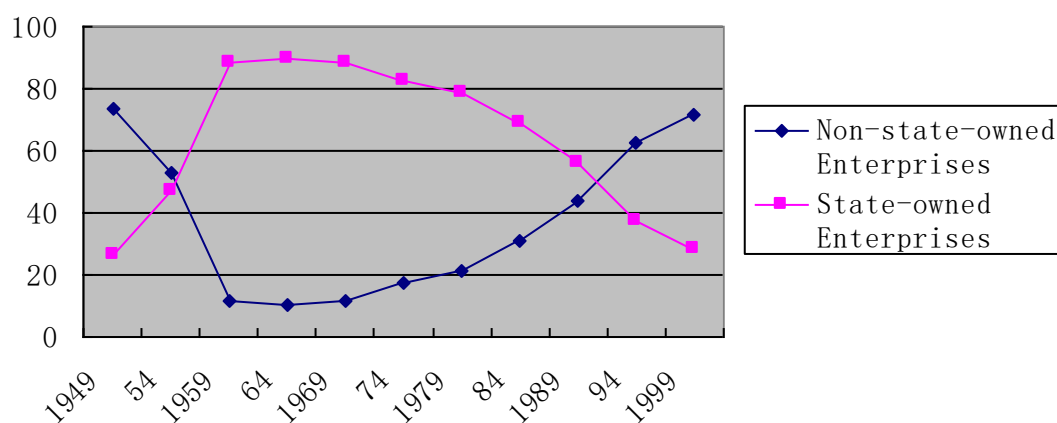
Time	Total Industrial Output Value and Proportion of Property Rights Structure					
	Total		State-owned Enterprises		Non-state-owned Enterprises	
	Money Amount	Proportion	Money Amount	Proportion of Property Rights Structure	Money Amount	Proportion of Property Rights Structure
1949	140	100	36.8	26.3	103.2	73.7
1954	515	100	242.7	47.1	272.3	52.9
1959	1483	100	1313.2	88.6	169.8	11.4

1964	1164	100	1042.3	89.5	121.7	10.5
1969	1665	100	1477.0	88.7	188.0	11.3
1974	2792	100	2300.9	82.4	491.1	17.6
1979	4681	100	3673.6	78.5	1007.4	21.5
1984	7617	100	5262.7	69.1	2354.3	30.9
1989	22017	100	12342.9	56.1	9674.1	43.9
1994	70176	100	26200.8	37.3	43975.2	62.7
1999	126110	100	35571.0	28.2	90539.0	71.8

Note: Confirmed from *Almanac of Chinese Statistics* and *Almanac of Statistics of Chinese Industrial Economy*

Figure 4.5.1b. Graph Showing the Proportion of the Change in the Structure of Property Rights in the Chinese Industrial Economy over the past 50 Years

Proportion (%)



In the modern world, the share of gross national product going through state and property right structure are the most important keys to economic performance. For example, in the industrial sector (see Figure 4.5.1c.below), in general the state-owned enterprises develop slowly because of their inefficiency, while private enterprises develop quickly due to their flexibility in business and high efficiency. A survey on national industry shows that China's state-owned industrial assets fell from 74.6 per

cent in 1985 to 37.1 per cent in 1999, and the collective economy dropped from 24.6 per cent to 19.7 per cent, while the private economy rose from 0.8 per cent to 42.3 per cent during the same period. In relation to employment as a whole, workers in state-owned enterprises fell from 41.1 per cent to 24.2 per cent while workers working for private companies rose from 8.9 per cent to 45.2 per cent.⁶⁴

All these figures show that during the 1980s and early 1990s, the transfer of the property rights of national assets was still not the government's main concern. The proportion of the state-owned economy fell gradually only because the non-state economy developed much faster than the state-owned one. State-owned industry fell 30.3 per cent in national assets from 1978 to 1994, during which it decreased 1.9 percentage points on average per year. Its industrial production value fell 40.3 per cent and it decreased 2.5 percentage points on average per year in the same period. This shows that a great deal of national assets were slackening and not being used efficiently. It is a great waste of social wealth.

Figure 4.5.1c. Table showing the Proportion of the Change in the Structure of Chinese Industrial Property Rights

	Total of Property					Total Industrial Output Value				
	Total	State-owned Enterprises		Non-state-owned Enterprises		Total	State-owned Enterprises		Non-state-owned Enterprises	
		Money Amount	Proportion	Money Amount	Proportion		Money Amount	Proportion	Money Amount	Proportion
1978	3477.6	3194.4	91.8	284.2	8.2	4237.0	3289.2	77.6	947.8	22.4
1994	62583.1	38477.3	61.5	24105.8	38.5	70176.0	26200.8	37.3	43975.2	62.7
2004	240706.8	109708.3	45.6	130998.5	54.4	222315.9	222315.9	31.6	152086.9	68.4

⁶⁴ Confirmed from p. 21, *50 Years Statistics of China's Industry, Transport and Energy*, published by the Chinese Statistical Press in 2000.

1978-1994 Proportion Change	Note 1			-30.3 percen tage point		+30.3 percen tage point			-40.3 percen tage point		+40.3 percenta ge point
	Note 2			-1.9 percen tage point		+1.9 percen tage point			-2.5 percen tage point		+2.5 percenta ge point
1994-2004 Proportion Change	Note 1			-15.9 percen tage point		+5.9 percen tage point			-5.7 percen tage point		+5.7 percenta ge point
	Note 2			-1.6 percen tage point		+1.6 percen tage point			-0.6 percen tage point		+0.6 percenta ge point

According to the statistics issued by the National Statistics Bureau, the state-owned industrial production value accounted for 90.6 per cent of the total national industrial production value in 1960, and then reduced year by year, from 88.5 per cent, to 78.3 per cent, to 62.3 per cent, to 54.6 per cent and so on. In 1998, the state-owned industrial production value accounted for only 28.2 per cent of the total national industrial production value while the production value produced by private industries rose to 9.4 per cent in 1960, and then increased year by year, namely 10.7 per cent, then 25.2 per cent, up to 30.9 per cent, to 53.1 per cent and so on. In 1998, non-state-owned industrial production value reached 71.8 per cent. The total industrial output value of non-state-owned enterprises exceeded that of state-owned enterprises starting from 1993 when the transition of the structure of property rights saw a fundamental change occur. Until 1998, the proportion of non-state-owned enterprises was 71.8 per cent but in contrast, that of state-owned enterprises was 28.2 per cent. In the meantime, the total industrial output value of non-state-owned enterprises was 8.5427 trillion RMB, over double that of state-owned enterprises which were 3.3621 trillion RMB (see figure 4.5.1d. below). These figures showed that improvement in property rights not only increased productivity enhancement but also raised social

returns and economic performance, from which resulted systems of inspiring mechanisms and the effective allocation of resources. Here, the CCP changed the structure of property rights through the state machinery and its political power, thus showing how important the political system is in influencing the economy in present-day China.⁶⁵

Figure 4.5.1d. Table of the Total Industrial Output Value and Proportion of the Structure of Property Rights

⁶⁵ Confirmed from the *Almanac of Chinese Statistics* and *Almanac of Statistics of Chinese Industrial Economy*.

Time	Total Industrial Output Value and Proportion of Property Rights					
	Total		State-owned Enterprises		Non-state-owned Enterprises	
	Money Amount	Proportion	Money Amount	Proportion of Property Rights	Money Amount	Proportion of Property Rights
1960	1637	100	1483.1	90.6	153.9	9.4
1961	1062	100	940.0	88.5	122.0	11.5
1962	920	100	807.8	87.8	112.2	12.2
1963	993	100	887.1	89.3	105.9	10.7
1964	1164	100	1042.3	89.5	121.7	10.5
1965	1402	100	1262.8	90.1	139.2	9.9
1966	1624	100	1464.5	90.2	159.5	9.8
1967	1382	100	1222.5	88.5	159.5	11.5
1968	1285	100	1136.2	88.4	148.8	11.6
1969	1665	100	1477.0	88.7	188.0	11.3
1970	2117	100	1854.7	87.6	262.3	12.4
1971	2414	100	2073.9	85.9	340.1	14.1
1972	2565	100	2177.2	84.9	387.8	15.1
1973	2794	100	2347.5	84.0	446.5	16.0
1974	2792	100	2300.9	82.4	491.1	17.6
1975	3207	100	2600.6	81.1	606.4	18.9
1976	3278	100	2567.7	78.3	710.3	21.7
1977	3725	100	2869.4	77.0	855.6	23.0
1978	4237	100	3289.2	77.6	947.8	22.4
1979	4681	100	3673.6	78.5	1007.4	21.5
1980	5154	100	3915.6	76.0	1238.4	24.0
1981	5400	100	4037.1	74.8	1362.9	25.2
1982	5811	100	4326.0	74.4	1485.0	25.6
1983	6461	100	4739.4	73.4	1721.6	26.6
1984	7617	100	5262.7	69.1	2354.3	30.9
1985	9716	100	6302.1	64.9	3413.9	35.1
1986	11194	100	6971.1	62.3	4222.9	37.7
1987	13813	100	8250.1	59.7	5562.9	40.3
1988	18224	100	10351.3	56.8	7872.7	43.2
1989	22017	100	12342.9	56.1	10860.2	43.9
1990	23924	100	13063.8	54.6	11670.4	45.4
1991	26625	100	14954.6	56.2	16774.8	43.8
1992	34599	100	17824.2	51.5	16774.8	48.5
1993	48402	100	22724.7	46.9	25677.3	53.1
1994	70176	100	26200.8	37.3	43975.2	62.7

1995	91894	100	31220.0	34.0	60674.0	66.0
1996	99595	100	36173.0	36.3	63422.0	63.7
1997	113733	100	35968.0	31.6	77765.0	68.4
1998	119048	100	33621.0	28.2	85427.0	71.8

The CCP was entirely aware that if it wanted to maximize the revenue of the group in power, it had to maximize the wealth of the society as a whole and so the CCP began its reform and opening up. From that time, since the economic reform, the private property rights in national industries rose from 0.5 per cent in 1978 to 40 per cent in 1998, with the collective economy only 31.8 per cent (according to an investigation by the National Industrial and Commercial Bureau, most property rights of the collective economy belong to private property rights but just in the name of State-owned enterprises in order to seek the State's protection). State-owned property rights fell from 76 per cent to 28.2 per cent in the same period. And the privatization process is still going on. It proves that one of the key measures in economic reform is the reform of the structure of property rights and the role of the government in economic development (see figure 4.5.1e. and figure 4.5.1f. below).⁶⁶

Figure 4.5.1e. Table of Total Change in the Structure of Industrial Property Rights

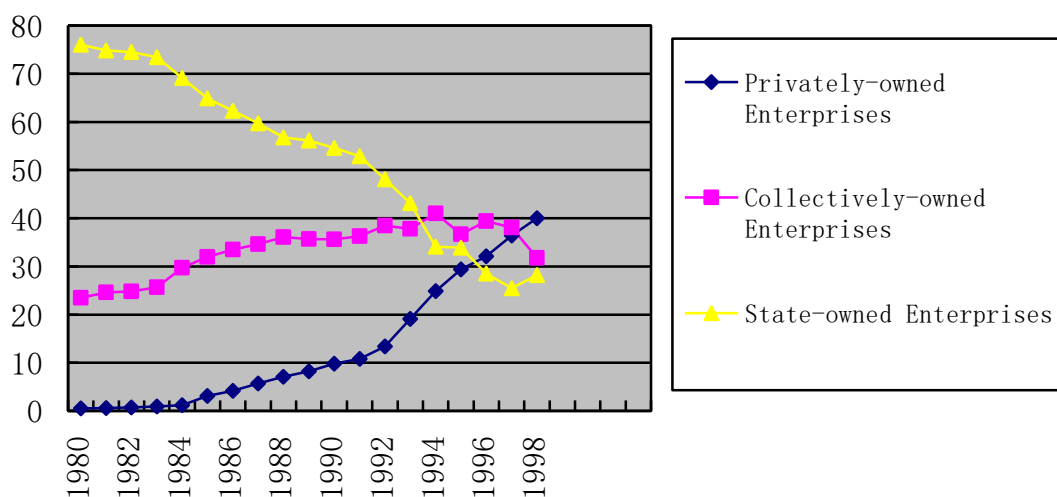
Time	Total Industrial Property Rights Structure		
	Privately- owned Enterprises	Collectively-owned Enterprises	State-owned Enterprises
1980	0.5	23.5	76.0
1981	0.6	24.6	74.8
1982	0.7	24.8	74.5
1983	0.9	25.7	73.4
1984	1.2	29.7	69.1
1985	3.1	32.0	64.9
1986	4.2	33.5	62.3
1987	5.7	34.6	59.7
1988	7.1	36.1	56.8
1989	8.2	35.7	56.1

⁶⁶ Confirmed from the *Almanac of Chinese Statistics* and *Almanac of Statistics of Chinese Industrial Economy*

1990	9.8	35.6	54.6
1991	10.8	36.3	52.9
1992	13.4	38.5	48.1
1993	19.1	37.8	43.1
1994	24.9	41.0	34.1
1995	29.4	36.7	33.9
1996	32.1	39.4	28.5
1997	36.4	38.1	25.5
1998	40.0	31.8	28.2

Figure 4.5.1f. Graph of Change in the Structure of Total Industrial Property Rights

Proportion %



From the angle of political theory, the modern problem of government has three fundamental features: “first, a view of the governed as a population consisting largely of autonomous persons; secondly, the belief that there is a rationality of government that is independent of sectional interests and values; and third, the existence of a state in the modern sense, that is, of a distinctive institutional structure independent of the person or persons of the ruler” (Vincent, 1997: 64). During the CCP’s rule, the government is not only the centre of politics but also plays a key role in both economic activities and social life. Once the CCP would like to specify and enforce the property rights structure, “the government also should be organized to achieve those aims” (Quinton, 1967: 20). The CCP normally uses violent means to realize its

aims. Laver and Blackwell (1983: 8) claim “the crucial difference between government and others is that decisions taken by governments can be enforced” but the CCP uses force in many fields and activities, such as political movements, economic activities, social life and cultural construction. Governments exert control over social groups through the various associations in their bailiwicks, often at the expense of higher authorities (Unger and Chen, 1995). In effect, if the CCP wants to develop the Chinese economy from its heart, the obstruction that hinders economic development must be removed through the political system and instead a democratic, liberal and loose political environment constructed. The government still plays a large part in the economy and China has a multi-command executive system in which some of the functions of central and local governments overlap. The state is ruled by men rather than ruled by law as the legal system is far from complete. The laws are often violated by power-holders and some regulations are imposed without legislation (Minami, 1994).

To survive and successfully evolve as a living social organism, the system of free markets, private property, and contractual buyer-seller transactions must operate with a legal order and in a politically democratic environment (Fan, 1994:3). But it is impossible to solve the problems of property rights and the role of government fully if the CCP still insists on the four cardinal principles, namely Marxism-Leninism and Mao Zedong Thought, CCP rule, dictatorship of the proletariat, and the socialist road. Observers of Communist orders have long pointed out that economic organization and political power are defined by the party-state’s bureaucratic control of resources⁶⁷ (Wank, 1999: 5).

Liu Xiangdong, a former top official of the Ministry of Personnel in the CCP, told the media that under the CCP’s leadership, so-called “freedom” was not protected by any

⁶⁷ Classic statements of this point are from Djilas (1957); Feher, Heller, and Markus (1983); Rizzi ([1939] 1967); and Trotsky ([1937] 1972) (Quoted from Wank, 1999: 5).

legislation. In essence, “freedom” is in irreconcilable conflict with the CCP’s dictatorship. Once such a conflict is beyond the CCP’s tolerance level, the CCP is able to take back all the “freedom” instantly. Therefore, how can economic freedom be protected if there is no social liberty? Deng Xiaoping has been marked down in history for his bold reform. But however bold and exciting the reform is, it still has to be accomplished within the framework of the political system constructed by Mao Zedong. In essence, Deng’s reform is still clumsy. In contrast, some say that the sacred Roman Empire was neither sacred nor Roman and that it was not an empire at all. The People’s Republic of China of course belongs to China, but is it really a people’s republic? It cannot be described as a republic without democracy, justice, safety and order. A government should always be monitored. In democratic countries, the separation of powers plus the freedoms of speech and press are good mechanisms for surveillance. The aim of every political association is the preservation of the natural and unprescribed rights of man. These rights are liberty, property, security, and resistance to oppression.⁶⁸ Hayek (1976) pointed out that only a just and effectual government can guarantee citizens’ safety and this government has to be sufficiently restrained and limited if it wants to prevent the abuse of power.⁶⁹

The dissident, Fang Jueshu, told the media that the CCP always thinks of itself as the Saviour of China, and that without the Communist Party, China would certainly be in chaos and that because the country’s area and population are so large that only the Communist Party can rule it, and if China collapsed, the world would be plunged into disaster. The CCP always says that it is a great, glorious and correct party but in reality, what has the CCP done since it took power in China from 1949? The CCP History Research Centre published a book in 1996, ‘Facts of the Political Campaigns after the Founding of the People’s Republic of China.’ The data shows that a series of

⁶⁸ Declaration of the Rights of Man and the Citizen (August 1789)

⁶⁹ During the classical period of Roman law it was fully understood that there is no conflict between law and freedom and that freedom is dependent upon certain attributes of the law, its generality and certainty, and the restrictions it places on the discretion of the authority (quotation from Hayek, 1960: 167: 253).

movements started by the CCP led to a set of tragic events: during the “Three Anti Campaign” and “Five Anti Campaign,” more than 323,100 people were arrested and over 280 people committed suicide or disappeared.⁷⁰ In the ‘Anti-Hu Fang campaign’ in 1955, over 5000 people were incriminated, over 500 were arrested, over 60 committed suicide, and 12 died from unnatural causes. In the subsequent suppression of the reactionaries, over 21,300 people were executed, and over 4,300 people committed suicide or disappeared. Another source, ‘Historical Records of the People’s Republic of China’ states that, “The number of unnatural deaths and reduced births from 1959 to 1961 is estimated at about 40 million...China’s depopulation by 40 million is likely to be the world’s greatest famine in this century”.⁷¹

Hua Lushui, a dissident, told the media that although Deng Xiaoping always states that the Party must change its political structure, even very small changes have not occurred in China. The reasons are that the self-interest and the material benefits have become the strongest coherent force for the unity of the CCP now. These members of interested groups connected and part of the CCP know deeply that if the dictatorship regime falls down, they would not only lose their power and positions but would also face investigation. Thus, the only goals of the CCP are to keep its power and status and avoid demise. The CCP controls and manipulates society, and monopolizes the resources of production, extracting wealth from all the Chinese people. Its sole aim is to maintain a political and self-interested group. In 1986, Deng Xiaoping said that “the content of the political reform is still under discussion, because this is a very difficult question. Since every reform measure will involve a wide range of people, have profound repercussions in many areas and affect the interests of countless individuals”.⁷² In effect, the CCP will certainly lose everything it holds, including

⁷⁰ It is confirmed from *Facts of the Political Campaigns after the Founding of the People’s Republic of China*. Edited by the CCP History Research Centre; The CCP History Publishing House.1996. *Historical Records of the People’s Republic of China*. Edited by the CCP History Research Centre; Red Flag Publishing House.1994.

⁷¹ Ibid, see footnote 87.

⁷² This is confirmed from a talk with Yoshikatsu Takeiri, Chairman of the Central Executive Committee of the

power, status and interest, if reforms are carried out and so everything the CCP does serves a political purpose in order to seize, maintain and consolidate its rule for its own self-interest.

The CCP has realised that “the two reforms must go hand-in-hand. Deng Xiaoping said that reform is the second revolution and the economic reform cannot go smoothly if there is no reform of the political system” (Gao, 1996). “If we do not institute a reform of our political structure, it will be difficult to carry out the reform of our economic structure.”⁷³ But as Lieberthal and Oksenberg (1988) point out, various factions were formed in informal ways to engage in rent-seeking activities, lobbying and bargaining for the increase of resource allocation to their domains. Networks of personal ties had also played an important role in increasing the capacity for collective action. Therefore, networks of personal ties make it possible for large groups of people to act for their collective interests. After gaining power, the communist parties consolidate their rule chiefly by eliminating their political opposition, and by establishing a governmental structure which carries out their orders. “For communist political systems there is a special problem because they came to power under a cloud of suspicion regarding their legitimacy....Communist rule by force, occasional purges, sporadic periods of terror have not lessened efforts of these leaders to win voluntary citizen support for their political legitimacy” (Gripp, 1993: 40-41). “Power is never the property of an individual; it belongs to a group and remains in existence as long as the group keeps together. When we say of somebody, that he is “in power”, we actually refer to his being empowered by a certain number of people to act in their name” (Ashe and Finlayson, 1999: 79 quoted from Arendt, 1970: 44).

Komei Party of Japan, on 3 September, 1986 (Deng, 1993).

⁷³ Deng Xiaoping speech, remarks made on 13 September 1986, after hearing a report from the Central Committee's Leading Group for Financial and Economic Affairs (Deng Xiaoping, 1993)

According to Henderson and Robinson's view, the political system of communism around the world has a common political feature: it is notorious for restricting the freedom of citizens and creating a closed society. The party's power dominates and corrupts all these variations in political structure in some way with State control of the economy and the political control of one party continuing to dominate the structure of everyday life. Therefore, political systems like these clearly obstruct the development of a country's economy and society. And once economic failure arises and stimulates political reform, the situation which occurred in most Eastern European countries, social opposition from intellectuals, young people and workers co-operating in different degrees of unity and cooperation challenged communist rule effectively and consistently. In fact, that communism fails utterly is not a fault of the founders but a failure in the system itself, especially the political system because multipartyism, political opposition, and freedoms of speech and press are the basis of the development of a country's economy and society. Although communist reformers also tried to discover a successful method to settle questions of economics and politics it still needed a "market" in economics and "democracy" in politics. For example, in the late 1980s "a substantial part of the Hungarian party and state bureaucracy discovered a way of converting their bureaucratic power into lucrative economic positions and assets (and indirectly also into a new type of political power) in the new system based on market economics and political democracy" (Prins, 1990: 30). But they would not like to step into this forbidden area because they would rather keep the whole state machinery in stagnation than give up their own power. For example, in Hungary, "the number of laws passed by parliament was, from the late nineteenth century up to 1948, an annual average of 37 per year. After the communists took power the yearly average of laws passed in parliament sank to five per year. This means that in practice the parliament actually did not work" (Prins, 1990: 22). The facts tell us that a system survives only because of its capacity, in a liberal political context, to adapt. Socialism encountered revolt because it failed to adapt. But when a long train of abuse and usurpation by a government aims to repress its people under absolute despotism, it is the people's right and duty to throw off such a government, and to provide new

guardians for their future security.⁷⁴

4.5.2. Social Problems in Perspective

Liang Yuhui, the dissident, told the media that for 50 years, the state has provided for its people everything they need from cradle to grave—from jobs and income to shelter, medical care, education, and retirement stipends. As the state-owned enterprise system is dismantled that umbrella of all-inclusive support. Since China's reform and opening-up to the world, the Chinese have not only sacrificed its ecological resources upon which China's survival depends, but also, what is even more devastating, is the near destruction of China's moral foundation and rich cultural traditions. Accompanying the fake prosperity of China's economy is the rapidly declining morality in all areas of society which is wreaking havoc on the Chinese nation.

Yong Zheng, an economist and dissident, told the media that at the beginning of China's reform and opening up to the world since 1979, shortly after this, although the peasants had increased their small amount of income because of the household contract system, they were plunged into poverty once again due to a price structure that forced industrial commodities over agricultural goods. The income gap between the urban and rural population has therefore drastically increased, and economic disparity continues to widen. It was inevitable that social problems would arise out of the political and economic crisis. China is focusing only on resolving short-term problems and neglecting the long-term factors such as environmental protection, its increasing population, urbanization, housing, and the plight of pensioners, the situation among the youth, the spread of corruption, equality, social mobility, security, religion and moral problems. As far as distribution is concerned, the rich are unhappy about the gap between their economic status and political status and they are seeking more political interest while the poor need a policy of balanced economic distribution to be enforced. From the point of view of the gap between urban and rural areas, the

⁷⁴ The Declaration of Independence, American Memory Collection, Library of Congress, July 4, 1776.

farmers have paid dearly for the accumulation of China's wealth, but they have gained little from the results of the reform. The ratio of urban to rural incomes has increased from 1.8 to 1 in the mid-1980s to 3.2 to 1 today (the year of 2005). In terms of the gap existing within districts, the underdeveloped areas, which are rich in resources, provide a boundless supply of resources to the developed regions and the developed regions have not compensated underdeveloped areas enough for the benefits they have received. The gap between districts in China is also widening.

Lei Huifang told the media that "China's investment in educational expenditure ranked as one of the smallest in the world. The average investment of world public education funding as a GNP ratio is 5.1%. The average educational investment of developed countries is 5.3%. In developing countries it is 4.1%: for example, in the developing countries such as the African countries of South Saharan it is 4.6%. In India it is 3.5% and in the least-developed countries it is 3.3%. In China it is 3.3 %, and it was less than 3% before 2001 (see the Figure 4.5.2). China's public health expenditure was only 4.5% of GDP and ranked as the 188th of 191 countries. In the United States it is 13.9%, and in Switzerland 10.9%. The lowest level set by the WTO is 5%, and the standard of the Organization for Economic Co-operation and Development (OECD) is 8.4%. China's rural population is 70% of total population but the total expenditure on medical services for on them is less than 20%.: of 1.3 billion Chinese people, 0.845 billion people have no medical insurance. China's input of educational and medical insurance is less than that of Uganda, which is one of the world's poorest countries, though the CCP claims that China's GDP has been in double figures for two decades."

Figure 4.5.2. The relationship between education funds expenditure and GDP from 1995 to 2003. Unite: Billion Yuan or %

Item	Gross Domestic	Financial Education	Practice as a proportion	Expected as a proportion	Input gap
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Time	Product (GDP)	appropriation	of GDP (%)	of GDP (%)	
1995	58478.1	1411.5	2.41	2.88	274.85
1996	67884.6	1671.7	2.46	3.07	346.22
1997	74462.6	1862.5	2.50	3.28	580.81
1998	78345.2	2032.5	2.59	3.50	712.94
1999	82067.5	2287.2	2.79	3.74	864.71
2000	89468.1	2562.6	2.86	4.00	1019.93
2001	97314.8	3057.0	3.14	4.00	836.91
2002	104790.6	3573.4	3.41	4.00	618.26
2003	116694	3722.5	3.19	4.00	945.22

Source: the green paper of the education in China (2000), China statistical yearbook (2003), China's fiscal yearbook (2003).

Ruchun Cui, an official in the National Bureau of Statistics, told the media that in 2004, the gap between the rich and the poor was also widening. Each family member in the highest income family group, which accounts for only 20 per cent of the total, enjoys a disposable income of 17,472 RMB while each family member in the lowest income family group has a disposable income of only 3295 RMB on average. The income ratio of the highest income group and the lowest income group has grown from 5.1: 1 in 2002 to 5.3:1 in 2006. The living conditions in the cities for those with little social welfare or pension is worrying. The government must establish a social-welfare safety net to deal with this problem and resolve the insecurity around income which is arising from the reforms of state-owned enterprises. The creation of new jobs, especially in the underdeveloped services sector, will expand the purchasing power of China's enormous population.

Li Changchun, a member of staff of the Ministry of Public Health, told the media that in the medical and sanitary field, a report from China's Consumers' Association

illustrated that 50 per cent of sick people in China are afraid of going to hospital for the simple reason that the medicines are too expensive and medical charges are too high. According to statistics, the number of people who can enjoy free medical care or labour insurance medical care is quite small compared with the size of China's large population. The number of people who received free medical care and labour insurance was 19.3 per cent of the country's population in 2001. By September 2004, the number of people who received town-worker medical insurance was 56.76 million, only 4.5 per cent of the total population. In rural areas it is difficult for peasants to go to hospital. Many of them have become poor because of illness, a common problem in the country. The number of people who benefit from the new cooperative medical service for rural areas accounts for only 10 per cent of the total rural population.

The dissident, Xin Aoguo, told the media that in terms of the problem of employment, China's regular employment is greatly affected by the pressure of its large population, contradiction of vocational structure and global competition of labour force. Other factors should also be considered, such as China's faulty social welfare system, impediments to labour flow, vocational discrimination, increasing labour disagreement, a slackening in the development of labour law and the coordinate mechanisms of labour relationships, poor employment service, untimely re-employment assistance and other faulty systems of job-finding. Even as scientific development influences the job market, employment will still be a tough problem which cannot be avoided in the process of China's social and economic development. It is very hard for most people to find a new job if they are made redundant. University graduates are quite worried about their employment, let alone those who do not have skills and who have outlived their usefulness for some jobs. It is a crushing blow for a family if a family member loses his or her job. Within this sea of entangled contradictions, people in China are uneasy about their society. From the point of view of commonality, community members almost all share a common feeling of insecurity, a sense of instability, a sense of uncertainty and dissatisfaction with corrupt and unqualified officials. This sense of insecurity pervades almost all

aspects of people's daily life, including food safety, housing demolition, medical and health care.

Ling Huchong, an official of the National Bureau of Statistics, and Ruchun Cui's colleague from the National Bureau of Statistics, told the media that according to a sample survey published by the National Bureau of Statistics concerning people's sense of security, criminal offences and public disorder have the most prevailing influence on people's sense of security. To people's dismay, the total number of criminal offences at present is still prodigious. Abominable, barbarous and violent crimes are constantly occurring. Cases of the illegal occupation of others' property and economic crimes are increasing rapidly and becoming more and more serious. Internet crimes are also increasing day by day. Gang crimes and illegal drug trafficking are causing great dangers to society, which gives rise to a series of grave social problems. Juvenile delinquency is also increasing. Crimes committed by a floating population are on the increase. The tendency of mobile and international crimes is increasing, making the crackdown on such crimes harder.

Petitioners, Hu Taofeng and Wen Gouzai, Both of them are not only victims of the CCP's system but have also been protecting farmers' interests and founded the China Farmers Association in 1993, but they paid the penalty for this: the CCP charged them with counter-revolutionary crime and gave them 10 years in prison. (The "counter-revolutionary crime" was changed into "the crime of jeopardizing state security" in China's criminal law in 1997.) They told the author when visited their village in China, that peasants have no medical insurance, no unemployment welfare and no retirement pensions. Peasants not only must pay a mandatory provident fund, public welfare fund, administrative management fund, an extra education fee, a birth-control fee, a militia organization and training fee, a country road construction fee and military service compensation fee but also must sell part of the grain they produce at a flat rate to the state as a mandatory requirement, paying agriculture tax, land tax, special local produce tax, and butchery tax in addition to numerous other levies.

Income for most peasants has stagnated or even declined. They have become poorer, and the income gap between urban and rural residents continues to widen. The number of item charges is shockingly high. According to the statistics issued by a concerned department of the government, the charges by 24 central governmental departments on peasants, including fund-raising and money collection, amounts to 93. The charges collected by local governments reach as many as 269, let alone numerous sideline charges. After all these years, poverty and backwardness still prevail in China because the government is tyrannical and because officials are only responsible to their superiors, not to the people.

Xu Hongwei, professor of politics at a Chinese university, told the media that although Chinese citizens live in such poverty and drudgery they still must not only support traditional municipal officials, but also as many or even more communist members of the party. The ratio between civilians and officials was 7954:1 in the West Han Dynasty (206 B.C.—24 A.D.); 7464:1 in the East Han Dynasty (25—220 A.D.); 2927:1 in the Tang Dynasty (618—907 A.D.); 2613:1 in the Yuan Dynasty (1271—1279 A.D.), 2299:1 in the Ming Dynasty (1368—1644 A.D.), 911:1 in the Qing Dynasty (1644—1911 A.D.); and 18:1 in current society since the CCP has come to power (1949—).⁷⁵ Today, the CCP has degenerated into a political entity struggling to maintain its self-interest. The CCP monopolize the resources of production and extract wealth from its society. There is no law, order and justice in China and all power belongs to the CCP.⁷⁶

4.5.3. The CCP Single-Party Dictatorship Will Not Produce Long-Term Economic Development.

⁷⁵ This is confirmed from the Analysis of the Third Census in China, the Publishing House of Chinese Finance and Economy, 1987 (Chinese edition).

⁷⁶ See also 'The just law is that which reason shows us as being apt to facilitate, or at least not to impede, the achievement of and preservation of a peaceful order of society.' (Max Rheinstein, "The Relations of Morals and Law", *Journal of Public Law*, I, 1952, p.298) (quotation from Hayek, 1976: 204-205).

Firstly, the single-party dictatorship institution cannot overcome an increase in corruption. In China, the Chinese Communist Party is the ruling party and represents only the party's benefits, not the people's benefits. The CCP has absolute control over all the state machinery: the army, jail, public security personnel, the police, paramilitary police, state security forces, procuratorate and judicial system. The CCP also has absolute control over all organizations and groups such as the National People's Congress, diplomatic personnel, religious groups, the circles of science and technology, democratic parties, workers' unions, the Youth Corps Committees and others. And in addition, the CCP has absolute control over all ideology and media communication such as magazines, hundreds of local TV radio station, newspapers, internet, China News Agency, and overseas China News media Services. "China now has more than two thousand newspapers, two thousand television channels, nine thousand magazines and 450 radio stations, but they are all under the watchful eye of the party in Beijing or provincial propaganda " (Hutton, 2007: 134).

In China, the party's organization extends everywhere and controls everything. All the government officials come from communist party committees, from the central government to the village or neighbourhood committees, including state-owned enterprises, not to mention the state machinery such as the army, prisons, the police and so on. Social ideology, ways of thinking, organizations, social structure, propaganda mechanisms and administrative systems all are controlled by it. The CCP's political power is an monopoly and controls and manipulates society, monopolizing the resources of production and extracting wealth from society which makes it very easy for corruption to proliferate. John Adams (1776) points out that power is always abused when it is unlimited and unbalanced and James Madison stated that "all power in human hands is liable to be abused" and that "power, wherever lodged, is liable, more or less, to abuse." ⁷⁷

Figure 4.5.3a. The number of CCP officials who have been found guilty of

⁷⁷ Lord Acton's and James Madison's maxim quotation from Hayek, F. A. (1960) *The Constitution of Liberty*. London and Henley. Routledge and Kegan Paul. p449-450).

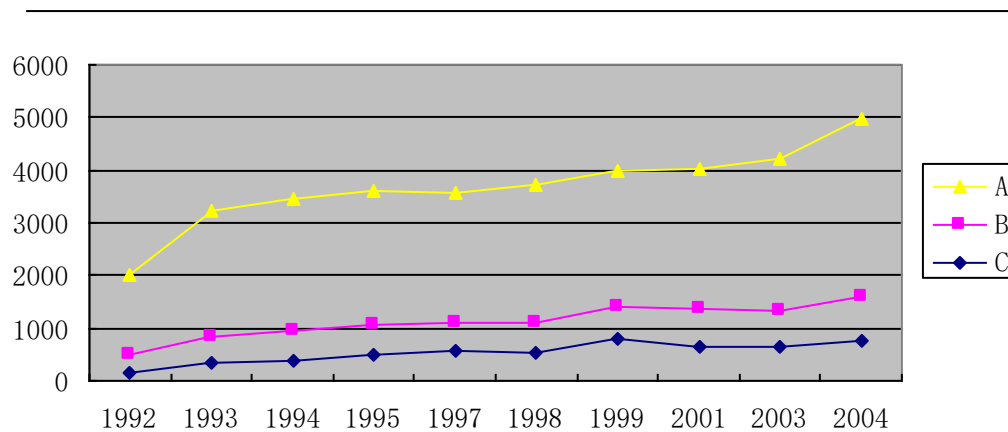
corruption (embezzling funds and taking bribes) by the courts, has escaped overseas or absconded.

items Years	The number CCP officials who have been found guilty of corruption (embezzling funds and taking bribes) by the courts	The number of CCP officials who have escaped overseas with illegal money	The number of CCP officials who have absconded with illegal money	Total number
1992	527	145	143	815
1993	739	297	356	1392
1994	852	343	395	1591
1995	956	367	486	1809
1997	946	454	564	3582
1998	1125	473	546	2144
1999	1259	609	786	2654
2001	1375	662	656	2693
2003	1565	698	643	2906
2004	1749	736	772	3257

Sources: *Forum of the World Outlook*. 24, June, 2005 (Chinese Edition). *Chinese Businessman* 18, January 2007.(Chinese Edition). *Newspaper of Beijing Youth*. 11, January 2005 (Chinese Edition).

Note: 1, the source is short of three years (1996, 2000, 2002). The author combines different sources to achieve the average number. 2, total number of the CCP's Officials is not the exact account (estimation of 20 million) as it is impossible to count the proportion. 3, the "abscondence" includes people who have remained in China or fled overseas. 4, excludes officials who have committed suicide. 5, this number is from China's mainland media but the overseas data is much bigger than this. The author has therefore adopted the conservative statistics.

Figure 4.5.3b. The comparative corruption chart of Figure 4.5.



A: The number of people who have been found guilty of corruption (embezzling funds and taking bribes) by the courts.

B. The number of people who have escaped overseas with illegal money

C. Those absconding with illegal money

It is easy to see that the CCP's corruption has grown, as shown between 1992 to 2004. In Figure 4.5.3a. and Figure 4.5.3b. above, the number of people accused of corruption increased from 572 in 1992 to 1749 in 2004, increasing each year at differing speed, apart from a small drop after rising in 1997. The tendency to escape overseas also shows the same tendency, falling a little after rising in 1997, and then increasing from 145 in 1992 to 736 in 2004. The abscondences rise from 143 in 1992 to 772 in 2004 and fall a little after rising in 1998. Although "it is reasonable to say that the leadership does realize the seriousness of Party (the CCP) decay, in fact, it has made enormous efforts to revive Party identity and provide society with a new vision" (Wong and Zheng, 2000:25), The disadvantages of dictatorship are inadequate information on which decisions are made, less than full use of available information, and simmering or suppressed discontent (Goyal and Jha, 2004). Therefore, the single-party dictatorship system is impossible to correct itself. This phenomenon obviously shows that the single-party dictatorship institution cannot overcome this increasing corruption.

The CCP has never had a democratic supervision system. In China, the government is able to exert, at any time, national force to handle and appease voices and actions against it from different walks of life. The CCP still persists in cracking down on

dissidents and people expressing free thought in order to protect its monopoly of power and “stability” (Pomfret, 1998). A government should always be monitored. In democratic countries, the separation of powers plus the freedoms of speech and press are successful mechanisms for surveillance. The CCP does not allow any opposition parties to exist, and in particular, Chinese people’s freedom of speech, the freedom of the press, obtaining information, spirit and will are all deprived. Unfortunately, many Western companies have also given up mechanisms of fairness and transparency and have adopted the nepotism, bribery and embezzlement in prevalent in China now. All of these effects are a result of the single-party dictatorship’s monopoly and the absence of a just government.

Regarding these issues, some scholars hold a different view. When the media interviewed Lei Hu, a researcher of the Policy Research Department of the CCP’s Party University on 26 June 2009, he told the media: “Western democracy has an outstanding feature, which is selfishness. The individual emphasizes democracy because it realises his personal interests, enterprises need democracy because they want to maximize their company's profit, and interest groups advocate democracy because they attempt benefit maximalization. Gorbachev pushed western democracy in the former Soviet Union but he was abandoned after democratization because there were not any interest groups that needed him and he was useless to everyone. If today’s China implements western democracy it will lead to the very serious result that all social wealth will rapidly become controlled by minority bureaucrats and most ordinary people will become down and outs. The social benefit mechanism will suddenly become unbalanced and social instability will also come.”

Lei Hu’s colleague, Doctor Zhang Faying, also spoke to the media when the media interviewed Lei Hu: “Money politics is inherent to the Western political system. Large capital groups grasp enormous wealth and money and make use of multi-party competition and electoral politics and regard elections as a commercial and marketing activity. In order to influence the choice of voters and achieve eventual election

victory, capital groups always control public information by taking over the campaign rules and the media. According to the report of US Federal Election Commission on 14 December 2004, the average election costs for one Senate election was about 2.51 million U.S. dollars, the maximum was up to 31.48 million and a single Congressman's average election costs were about 0.51 million dollars, with a maximum of 9.04 million in 2004. Just imagine, please, if there is no financial support for a large capital group, how can one compete for power? If election does not rely on the power of money, how can candidates in the competition? In the Western capitalist system, no matter which political party comes to power, it is actually representatives of the bourgeoisie and large capital groups who control political power over state power. Our great communists neither control the operation of the media nor public information because the CCP is a ruling party which is elected by the people and it is impossible for it to be replaced by any other party. Our party does not rely on a penny but can still rule long-term; this is truly remarkable.”

As Hayek (1976:158) states, “the establishment of a just and effectual government is of all circumstance in civil society the most essential to freedom: that everyone is justly said to be free in proportion as the government under which he resides is sufficiently powerful to protect him, at the same time that it is sufficiently restrained and limited to prevent the abuse of this power”. Whether the government ought to possess an exclusive right is of decisive importance, not merely a question of efficiency but of crucial significance for the preservation of a free society. In the free market economy, the economic self-interest of the individual reigns supreme and almost the sole factor governing relations is the profit motive. The government must provide benefits for the people and work for the general welfare of the people. But it is impossible for a single-party dictatorship as the CCP cannot produce long-term economic development. As Dorn (1998) says, as long as the CCP adheres to single-party rule, corruption will continue to pollute China’s economic environment.

“The most important example is that the regime of Communist China intends to suppress all pro-democratic and human-rights movements in order to ensure the

continuity of its dictatorship” (Menges, 2005: 478).

Secondly, social fair competition and justice is hard to realize. As a defective market economy system, the dual track approach (one is a planned economy and another is a market economy in the same country with any of several other related or similar is the planned price and market price, also see Chapter 5.5.) makes it very easy to produce corruption. Corruption leads to an unfair economy and rise in the disorder of the markets and the decline of the economy. The transition to fair, transparent, stable and secure constitutional rules is incompatible with the dual track approach, which features arbitrary and discretionary government power and unfair, unstable, uncertain, and obscure rules. The CCP’s officials are the rule makers, the rule enforcers, the referees, and the players all at the same time. Once government has given up justice for the sake of interested groups, it gives up responsibility for any person’s fate or position. In an unfair society, some people are worse off than others because of corruption in authority. The widespread corruption within the Party and government and the increasing inequalities of income are the two causes of growing public unrest, which exists not only between the wealthy few and the vast majority of still-poor Chinese, but also between the cities and countryside and between the rapidly developing coastal east and stagnant interior and western regions of China (Eckholm, 2001). According to Hayek (1988), efficient institutional arrangements can emerge only as a result of such fair competition and voluntary trade. The lack of fair competition also implies that the institutional arrangements that are chosen cannot be efficient. Also, the Chinese style socialist economic system is the first system that was purposely designed by a government rather than emerging from the spontaneous evolution and from the interactions of players through fair competition and the voluntary trade of property rights. The CCP’s single-party dictatorship mechanism itself brings about unfair results for society but a multi-party democracy is virtually an indispensable means for the achievement of a just and rational economic order. Justice is the achievement of and preservation of a peaceful order of society. But Mr. Lei and

Zhang also have their own points of view. Doctor Zhang Faying says: “China is not suitable for multi-party democracy and general elections. China has pushed the experiment of direct elections at village level but it is very bad because buying of elections is an open secret, there is bribery and vote buying in elections and villagers are willing to accept this fact and the phenomenon that ‘whoever gives me the greater benefit, I will vote for him’. The villagers never think about who is more competent to fill the office. So we have many problems to face with democracy, which includes a large number of the people themselves.” Lei Hu told the media: “I think that the western democratic system seems to be quite good, but it is not suitable for China now because the situation of contemporary China is too complex. If China copies the western pattern, there will be serious consequences that will be the same as in the former Soviet Union and Eastern Central Europe, and it means that the state will become divided and there will be even more confusion than in the former Soviet Union and Eastern Central Europe. You must understand that we are a socialist country and the struggle between the Socialist camp and the Capitalist camp will never end. If the western world strongly advocates so-called democracy, which can really bring a wealthy and strong socialist country, what is the real western motive? Do you believe that the West is willing to see a powerful socialist country become a competitor?” North (1981) points out that only when the members of a society believe that the institution is fair and they do not violate the regulations and property rights will the costs of regulations and property rights enforcement become greatly reduced. After the CCP established the government in 1949, it set up a very unfair system, for example, the residential registration system where the system forcefully classifies people into rural and non-rural populations, creating an unreasonable separation and opposition within the country. The non-rural population does not pay numerous additional levies, fees and taxes. The rural population not only has to pay various taxes and fees but also does not have social insurance and welfare. “Social fairness is not only a moral but also political issue because the sense of injustice is fuelling social tensions and outbreaks of violence” (Fewsmith, 2001: 139).

In China, the CCP has monopolies in transport, banks, aviation, communications, publishing and energy supply. Monopoly does not only prevent competition but also limits personal liberty. Hayek (1976:158) states that “it is under just restraints only that every person is safe, and cannot be invaded, either in the freedom of his person, his property, or innocent action.” People do not seek justice from the government if economic disputes arise between individuals or groups because the judiciary is united to the executive power and legislation and no organization is independent from the CCP. “When the judiciary is united to the executive power, it is scarcely possible that justice should not frequently be sacrificed to, what is vulgarly called, politics” (Smith, 1776: 545). What China needs is a government of limited powers that respects the life, liberty, and property of each individual. “By setting up a minimum group of constraints and letting human creativity work freely, we can create a better society without having to design it in detail. That is not a new idea; it is the idea of law, the idea of a constitution” (Hu, 1991: 44). Chinese ancient culture and the principle of spontaneous order - the central principle of a true market system - is the beacon for China’s future as a free and prosperous nation (Dorn, 1998), which “is the idea that individuals seeking their own gain in a system of private ownership and free markets bring about mutually beneficial exchanges, and that competitively determined prices coordinate economic decisions without central planning” (Dorn, 1998). The CCP’s aim does not preserve and enlarge freedom but instead abolishes or restrains freedom. The precondition for a centralized power is to establish a monopoly of power in sectors of government. “We need to make everyone equal before the law and set the rules of conflict resolution.”⁷⁸ Mao Yushi is an economist and researcher at the Yanshan Institute. He has given his signature many times to calls for the release of political prisoners, and appealed to the CCP authorities to take advantage of the liberalization of the press, freedom of speech and the legalization of political parties. In Mao Yushi’s opinion, liberty, not democracy, should be the primary concern. The

⁷⁸ *China Rediscovered Hayek*, interview with Mao Yushi, Wall Street Journal, June 12, 1998 (cited from Dorn, James A. (1998) *China in the New Millennium: Market Reforms and Social Development*. Washington, D.C.: Cato Institute.)

challenge for China is to allow liberty to grow by adopting constitutional constraints on government power.

There are two case studies in this thesis: the incidents concerning Yang Rong and Sun Dawu. The former showed property rights being specified and enforced and the latter illustrated that the unfair behaviour of government and a defective legal system are harmful for free market economic development. Both cases indicated that monopoly and dictatorship does not facilitate economic performance. Accompanying the fake prosperity of China's economy is the rapidly declining fairness and justice in all areas of society and social conflicts have been built up to a level never seen before. This danger of governmental action also causes inefficiency of a monopoly and unfair competition. As Hayek (1976) claims, people must object to any powers of monopoly exerted by government, even if such a monopoly promises services of higher quality, because if a government only uses its monopoly, then it is liable to be abused.

Thirdly, China has paid a very high price for economic development. From the 1980s to the end of the 1990s, desertification in China increased from a little over 1000 to 2460 square kilometers (386 to 950 square miles). The per capita arable land also decreased from about 2 Mu⁷⁹ in 1980 to 1.43 Mu in 2003. The widespread upsurge of land enclosure for development has led China to lose 100 million Mu of arable land in just a few years. However, only 43 per cent of the confiscated land is actually used. Currently, the total amount of wastewater discharge is 43.95 billion tons, exceeding the environmental capacity by 82 per cent. In the seven major river systems, 40.9 per cent of the water is not suitable for drinking by humans or livestock. 75 per cent of the lakes are polluted so as to produce various degrees of eutrophication.⁸⁰ The conflicts between man and nature in China have never been as intense as they are today. Neither China nor the world can withstand such unhealthy growth. Deluded by the superficial splendor of high-rise buildings and mansions, people are unaware of the impending ecological crisis. The rapid economic growth in the past 30 years is on the basis of sacrificing the opportunities of future generations and the excessive use of

⁷⁹ *Mu* is a unit of area used in China. One *mu* is 0.165 acres.

⁸⁰ Data from a report by *Xinhua News Agency* on February 29th, 2004.

resources will lead to environmental destruction and a waste of social resources.⁸¹ All these and other environmental problems increase discontent in both the countryside and in towns and cities, and they are also perceived as the direct responsibility of the Party. China's economy has badly affected the ecological environment and resources and this consumption of resources needed for sustainable development is impossible to maintain for a long time as China's economy is crippled and defective.⁸² "China paid a high price for such an achievement. The economy is very inefficient because of low allocated efficiency and low technical efficiency. In the current stage of China's economic development, capital is relatively scarce and labor is relatively abundant. If price were determined by market competition, capital would be relatively expensive and labor relatively inexpensive. Therefore, the comparative advantages of the Chinese economy lie in labour-intensive sectors" (Lin, Cai, and Li, 1996: 226, with more detail on chapter 5.6.)

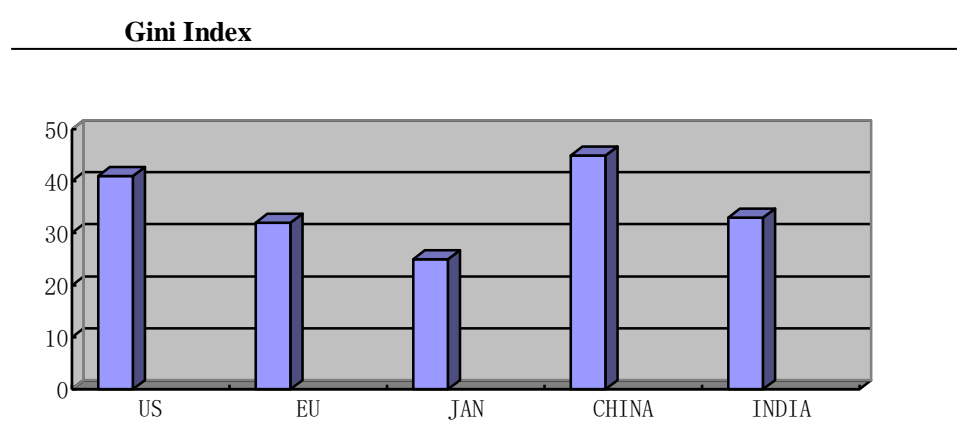
Fourthly, the gap between the rich and the poor is growing in line with the increase in economic development. The report of the World Bank in 2006 showed that 0.4 per cent of China's population had 70 per cent of China's wealth but in the US, 5 per cent of the population hold 70 per cent of wealth. China's extent of wealth is a vital issue now and it has become a highly polarized country. This also is can be seen in their so-called Gini coefficients—a statistical measure of the dispersion of income shares within a country. A Gini index reading of "0" represents perfect equality, with each segment of the income distribution accounting for a proportionate share of total income. Conversely, a reading of "100" represents perfect inequality, with the bulk of a nation's overall personal income being concentrated at the upper-end of the

⁸¹ Burgh also claims(2006: 160): "The potential of China's problems to damage the rest of us is at least as alarming to observers as those within. Fifty per cent of the world's population needs water that originates in Tibet, and could suffer terribly from mistakes made by the PRC; China's carbon dioxide emissions are seen as a major cause of global warming."

⁸² Ching also claims (2008: 83): "Although the size of the Chinese economy is huge and in all likelihood will become the world's largest in a matter of decades....the country has paid a huge price for its rapid growth. China is the world's second largest greenhouse gas emitter behind the United States, and may well by now be number one. And according to the World Bank, sixteen of the world's twenty most polluted cities are in China".

distribution spectrum. In other words, the higher the Gini Index, the more unequal the income distribution. As can be seen in Exhibit 4, the latest Gini Index readings for the US (41) and China (45) are among the highest of all the major economies in the world—pointing to a much greater incidence of inequality than in economies with more homogeneous distributions of income, such as Japan (25), Europe (32), and even India (33). (See figure 4.5.3a.).

Figure 4.5.3c. A Value of 0 Represents Perfect Equality, a Value of 100 Perfect Inequalities (Income Inequalities).



Source: Morgan Stanley Research. April 2006 .UN.

In China, it is a different story altogether. China remains very much a tale of two economies—a booming development model at work in the increasingly urbanized coastal part of the nation in stark juxtaposition with the relatively stagnant economic conditions persisting in the rural Central and Western portions of the country. While 560 million urban Chinese are now participating in the economy’s rapid development dynamic, this still leaves a rural population of some 745 million on the outside looking in. Interestingly enough, the accelerating trend of rural-to-urban migration has done little operation to the inequalities of the Chinese income distribution over the past 15 years (1991-2006). This is somewhat surprising in that the urban per capita incomes in China (US\$1,531 in the top 35 cities in 2004) are slightly more than three times those in rural areas (\$488). But the increase in China’s overall Gini Index from 35 in 1990 to 45 in 2003 not only reflects the impact of an ever-widening income

disparity between coastal China and the rest of the nation, but it is also a function of the mounting inequalities in the distribution of urban incomes(Roach, 2006). On this latter point, a recent report of China's Academy of Social Sciences notes that average income in the bottom quintile of urban Chinese workers is less than 5 per cent of the average in the upper quintile. The polarization becomes much bigger as economic development increases.

Finally, democracy is likely to facilitate economic performance. When thinking about economic development, democracy and economy are inextricably interlinked in any understanding of the performance of an economy. As Bardhan (1999) claims, most of us believe that democracy is not merely good in itself, and it is also valuable in enhancing the process of development. In democratic countries, the government is not only monitored by the opposition parties but also supervised by public opinion. Although autarchy can also deal with changes in technical and market conditions through its flexibility, and correct wrong decisions sometimes, democracy also helps economic development through the accountability mechanisms. Democracy still has the capacity to limit the abuse of executive power, and provides a system of periodic punishments for undesirable government interventions in the economy and rewards for desirable interventions (Bardhan 1999). Democracy does not only maintain a fair and competitive market, but it can also prevent and reduce corruption in economic activities. In the meantime, democracy can also avoid delays in decision-making and mend its errors. As Adam Michnik, a veteran of the Polish struggle for democracy, stated in his 1996 speech⁸³ in New York: "only democracy has the capacity to question itself and the capacity to correct its own mistakes."

In comparison, since abandoning communism, Russia has carried out economic and political reforms at the same time. After experiencing a short period of agony, it has embarked on rapid development. From 1999 to 2003, Russia's GDP increased by a total of 29.9 per cent. The living standards of its residents have also significantly

⁸³ Reported in the *New Yorker*, December 9, 1996.

improved. Even India, a country that, to most Chinese, appears poverty-stricken and full of ethnic conflicts, has enjoyed significant development and achieved an economic growth rate of seven to eight per cent per year since its economic reforms in 1991. India has a relatively complete legal system in a market economy, a healthy financial system, a well-developed democratic system, and a stable public mentality. The international community has recognized India as a country of great developmental potential. It has been deduced that there is a relationship between democracy and economic development, especially among newly democratic and non-democratic countries in Asia. China is a post-socialist state that has produced high-speed growth in economic performance, which indicates that China's economy took off because the liberal economic reforms of the 1980s had made the country less authoritarian (see Chapter 5.3, 5.4, 5.5). When a new Asian economy is taking off, which development model - authoritarian or democratic - is more likely to accelerate economic growth? After several decades of contestation, an answer seems to be emerging.

Early in December 1987, the United Nations listed Burma, a dictatorship with a military government, as one of the world's least developed countries, with a gross domestic product of 149 billion US dollars (and by the year of 2001, Burma's per capita gross national product was only 267 US dollars).⁸⁴ Another autarchic country, North Korea, can be compared with democratic South Korean, taking the year of 1995 as an example. In 1995, the economic growth rates were North Korea - 4.5%, South Korea - 9.4%; GDP in billion US dollars was North Korea - 1,310, South Korea - 4,565; GDP per capita in US dollars was North Korea - 740, South Korea - 11,450. In 1960, GDP per capita in North Korea was 253 US dollars, and in South Korea 83 US dollars, but in 2004, it was 86 US dollars in North Korea and 12,451 US dollars in South Korea.⁸⁵ From this comparison, it emerges that in 1960, North Korea's per

⁸⁴ Source: International Economic Information, China National Bureau of Statistics, 16 December 2005.

⁸⁵ Source: the original title: Comparative Analysis of inter-Korean economic situation, Learning and Exploration, Magazine, P12-18, 2006 No. 1.

capita GDP was three times that of South Korea, but by 2004, South Korea's per capita GDP was 145 times as that of North Korean. Since the 1990s, North Korea's economic development has been deteriorating, with 9 consecutive years of negative growth from 1990 to 1998: -3.7, -5.2, -7.6, -4.3, -1.7, -4.5, -3.0, -6.8 and -1.1 respectively.⁸⁶ In the past 20 years, particularly since the 1992 democracy movement when Thailand started with a more relaxed political environment and social stability, Thailand's economy has maintained a high growth rate, which is related to the liberalization of political and economic policy. Its average annual growth rate has been maintained at about 8%, and per capita income is now more than 2500 US dollars, so the World Bank included Thailand among middle-income countries in 1995. Taiwan has relieved martial law and the ban on political parties and practised free elections since 1987, and the GDP annual per capita income increased from 4905 US dollars in 1987 to 11,692 dollars in 2001. The GDP average annual growth rate was 8.1% from 1981 to 1990.⁸⁷ The United States helped and supervised Japan in promulgating a new democratic constitution in May 1947, so that democratic institutions pushed the Japanese economy into entering its period of rapid economic development. During 1956 - 1973, the Japanese GDP average annual growth was more than 10%, and the average industrial growth rate reached 13.6%. Its economic output led it to become the second largest economy after the United States, and in 2006 Japanese GDP per capita income was 37,000 dollars.⁸⁸

It is very interesting to consider the experiences and developmental path of the following two Asian countries: authoritarian China and democratic India. At the beginning of the Asian economic take-off in the 1980s, China's "authoritarian

⁸⁶ Diamond, L. and Shin, D. (2000) Institutional Reform and Democratic Consolidation in Korea, Hoover Institution Press, Stanford University, USA.

⁸⁷ Taiwan Statistical Data Book Taiwan's Executive Council, Taipei, Taiwan. 1990: p23-24; 2001: p41-43.

⁸⁸ China Economic and Trade Tribune in 2006 No. 7, p9-11.

border” was coming down, but the Indian miracle should debunk the idea that democracy is bad for growth. Since the 1990s, Chinese welfare and household income has declined, the state of education and health are not good, and inequality has reached an alarming level etc. (for more details, see Chapter 4.5, 5.6). On the other hand, India started its own economic take-off, and its annual economic growth rate increased from the previous 2-3% annually to 8-9% annually now. The per capita GDP increased from 317 US dollars in 1990 to 634 US dollars in 2006. “The economic dividends of political reform don't appear overnight, which skews the timeline and confuses the cause. But by using nearly every metric, political liberalization has spurred rather than stunted growth in both China and India.... Political reforms are not antithetical to economic growth because they are the keys to a healthier and more sustainable foundation for the future.... Democracy is good for economic growth after all”⁸⁹ As Goyal and Jha (2004) point out, democratic freedoms can enhance innovation and development, which gives an advantage to India in the long-run, unless China allows more democratic freedom for its people. China has a one party authoritarian regime which can take quick flexible decisions but also imposes sacrifices on its people. China does not have private property rights and a functioning market, and also mutes the demand for more democratic freedoms. Huntington (1991) points out that as everyone knows, there is an inextricably interlinked relationship between democracy and economic development. Most of the richest countries in the world are democratic countries, except Singapore and oil-producing countries, which are special cases. Almost all the poorest countries in the world are not democratic, apart from India and one or two other special cases. Democracy is one of the underlying determinants of the long-run performance of countries' economies.

4.6. Conclusion

⁸⁹ Huang, Yasheng(2008) New Asian miracle,(Cover article) Foreign Policy, US., magazine, August 6, 2008

According to Hayek (1949), it is impossible to avoid the low economic efficiency caused by the centralization of state power in a socialist system because a centrally planned system has within its structure dangers to personal and political freedom. As soon as the state takes upon itself the task of planning the whole economy, the problem of the due status of different individuals and groups must indeed inevitably become the central political problem.⁹⁰ “There will be no economic or social questions that would not be political questions in the sense that their solution will depend exclusively on who wields the coercive power, on whose are the views that will prevail on all occasions” (Hayek, 1944:80). The reason why the economic reform of all eight Eastern European countries and the Soviet Union failed was political reform. The rulers just wished to get rid of crises such as social problems and economic depression in order to save their political status but it is impossible to be successful in reform unless there is upheaval, revolt and revolution. For example, in Hungary and Poland, party leaders were prepared to sacrifice important elements of ideology for the sake of coherence in their economic reform, “but found it impossible to put the reform into practice because of the resistance of bureaucratic interests entrenched in the power structure upon which their own positions ultimately depended” (Batt, 1991:72). As is known to all, the economic base determines the superstructure but the superstructure has a huge reacting force on the economic base. Sometimes the superstructure - in which the political system will play the key role - is one of the main signs of progress in a society, whether positive or negative, and in particular, in some countries where state power is controlled by a dictatorial and autocratic regime. In fact, some communist leaders have tried their best to abolish outmoded regulations and eliminate irrational practices, but these efforts have been inconsistent and unsuccessful. The accumulation of these failures has resulted not only in deepening economic difficulties but also in the political exhaustion of the regimes themselves. Fortunately, communism broke down in 1989

⁹⁰ See also, “In the hands of an irresponsible controller even socialist planning could be made the greatest tyranny the world has ever seen” (Dr. M. Dobb, *Political Economy and Capitalism* .1937, Chap. Viii).

because it had proved quite unable to reach the vision described and promised by Marxism and Leninism, namely economic modernization, material welfare and social justice. Which is better, capitalism or socialism? The answer has been proven by history and reality after the price has been paid by many people. “So, to summarize: capitalism in its original or pristine form could not have survived. But under pressure it did adapt. Socialism in its original form and for its first tasks did succeed. But it failed to adapt, and it nurtured an oppressive and repressive political structure” (Prins, 1990: 7).

It is possible that after the potential for mimicking has been exhausted, China’s new pattern of socialism may fail to work, as what happened to Soviet-style socialism after the successful imitation of the old capitalist industrialization at the end of the century. As Sachs and Woo (1994a) suggest, the strategy of imitating the industrialization pattern of a capitalist developed economy, in the absence of a capitalist institutional infrastructure, can generate short-run impressive growth performance. However, as the potential for the imitation becomes exhausted or as the network of the division of labour becomes increasingly more complex, the long-run cost of this strategy will outweigh its short-run benefits since this system does not have an institutional infrastructure that can create its own capacity for economic development and institutional innovations. Theoretically, these changes in the economic system, by increasing efficiency, should benefit everyone and the redistributive effects of changes in the rules of the economic game are bound to create group conflict (Pratt and Zeckhauser, 1985). The CCP’s requirements for political reform do not conform to the historical trend of the times. They “just eliminate organizational overlapping, overstaffing, bureaucracy, sluggishness, and endless disputes over trifles. Through the reform, we intend to straighten out the relationship between the rule of law and the rule of man and between the Party and the government. We should be firm about leadership by the Party.”⁹¹ “For by Marx’s own hypothesis it will work for his class

⁹¹ From a meeting that Deng had with Yoshikatsu Takeiri, Chairman of the Central Executive Committee of the Komei Party of Japan, on September 3, 1986. See also: *In my opinion, its purposes are to bring the initiative of the*

interests” (Olson, 1971: 106). The CCP established a predatory hierarchy in order to extract funds from the economy to mandate corrupt activity and corruption is endogenous to its political regime. Olson (1982) suggests that the dense network of distributional coalitions that eventually emerge in stable societies is harmful to economic efficiency and growth, but so is instability also. Unstable countries lead to the misallocation of resources and most rapid growth will not occur in societies. Huntington (1991) pointed out that in the long-term economic development creates the basis for democratic regimes. In the short-term, very rapid economic growth and economic crises may undermine the authoritarian regimes. The CCP engages only in economic reform without political reform. The false appearance of an economy that flourishes in the short-term has hindered the natural “evolution of social systems”. It is this incomplete reform that has caused an increasing imbalance in Chinese society and sharpened social conflicts. The financial gains achieved by the people are not protected by a stable social system. In the process of privatizing the state-owned properties, the CCP’s power-holders have utilized their positions to fill their own pockets and too much state assets lost. Only the present political institutions have to be changed then the China can go to thriving and prosperous. ⁹²

masses into play, to increase efficiency and to overcome bureaucratism. (Remarks made on September 13, 1986, after hearing a report from the Central Committee's Leading Group for Financial and Economic Affairs.); *political reform just eliminates organizational overlapping, overstaffing, bureaucratism, sluggishness, endless disputes over trifles* (Deng Xiaoping speech, June 10, 1986; Remarks on the Domestic Economic Situation, which is taken from Deng Xiaoping, 1993).

⁹² As Veblen correctly pointed out, the idea is utilitarian, and more closely related to Bentham than Hegel. Both Marxism and liberalism make the same rationalist assumptions that men, given the opportunity, will naturally come to political consciousness of interests, of self or of class (Olson, 1971: 104-105).

CHAPTER FIVE

ASSESSING CHINESE REFORM AND OPENING UP TO THE OUTSIDE WORLD SINCE 1992

5.1. Introduction

Since 1979, China has switched the focus of its work to economic construction, the reform and opening up to the outside world and set the goal of building socialism with Chinese characteristics. This has further expanded its social development and progress. No doubt, since 1978, China has not stopped pushing forward its reform and opening up policy, and as a result, its market economy system after going through three courses, namely the planned economy as the mainstay and market regulation as a supplement, the planned commodity economy, and establishing a socialist market economic structure at that time in China. The CCP wishes to establish and form a large and open market economy whilst not touching political reform at all, but this has caused many problems which have blocked China's social and economic development.

At the beginning of its economic system reform, because of the successful imitation of old capitalist industrialization, the economy developed rapidly and achieved much from its reform and opening up since 1978. Its social productivity and comprehensive national power have been constantly enhanced, and the overwhelming majority of Chinese people have witnessed a historic transformation from basic life conditions to a prosperous society. Statistics from the National Bureau of Statistics show that the state has continued to increase the input into science and technology to ensure the steady development of the scientific and technological sector. "Few countries have changed so rapidly as China over the past dozen years. Some of the changes are visible to the naked eye in the skyscrapers along the main streets, the dress of pedestrians, the increase in motorized traffic, the improvement in shopping facilities, the revolution in the supply of consumer durables. Other changes can be seen in the

statistics of GNP, investment and trade: GNP has more than doubled in a decade, investment has increased even faster and trade has expanded astronomically” (Sir Alec Cairncross, quoted from Shangquan Gao, 1996: xii). Although China has made great achievements, various problems still exist, for instance, its huge population, weak economic basis, under developed productivity and unbalanced development as well as the comparatively conspicuous contradiction between its environmental and natural resources and the developments of economy and society. China’s GDP per capita, exceeding USD 1000, is not yet listed in the top 100 in the world. This indicates that Chinese people still need to make long-term untiring efforts that will completely change its economic and political institutions, especially concerning political democracy and liberty, and achieve a complete market economy in order to realize modernization and live a wealthy life.

Presently China’s overall GDP is ranked sixth in the world, and the total amount of its imports and exports, the fourth. The crucial reason why China has achieved this place is that such great changes not only lower its initial level of development, which is easy to be promoted, but also that the CCP for the sake of maintaining its rule has constantly persisted in its road of development through reform and opening up policies; abandoning the communist planned economic system; imitating the old capitalist industrialization which stirs up the Chinese people’s positivity, motivation and creativity. Reform has made China powerful and prosperous and China has achieved tremendous success, attracting worldwide attention. It has also confronted difficulties and problems such as inflation, a reduction in foreign exchange reserves, bribery, corruption, economic crimes and enormous financial deficits. When focusing on reform-minded China and assessing economic growth objectives, it is necessary to emphasize quality over quantity. Short-term operations have led to the curse of the latecomer, resulting in environmental concerns, income disparities, and a social safety net being needed, and the imperative of productivity are all viewed as increasingly important aspects which will ensure the quality of Chinese growth objectives (Roach, 2006).

5.2. Relying mainly on the creation of a planned commodity economy of public ownership from 1987-1992

In October 1987, at the 13th Party National Congress, the Party general secretary Zhao Ziyang⁹³ put forth the view that China was in the primary stage of socialism. According to this theory, China was at the primary stage of socialism and would remain so for a long period that would last for at least a century and that this stage could not be skipped over. The Party Congress asked to establish the basic framework of a new planned commodity economy step by step. The Congress announced that they would quickly establish the market system of socialism, and the creation of a new basic framework of a planned commodity economy. But one centre and two basic points⁹⁴ being put forward meant that everything was still controlled by the CCP. At the same time, however, political dissent as well as social problems such as inflation, urban migration and prostitution emerged, and various public officials and civil servants exhibited self-interested and irresponsible behaviour and bureaucracy. Although students and intellectuals urged greater reforms, some party elders increasingly questioned the pace and ultimate goals of the reform program.

In December 1986, student demonstrators, taking advantage of the weakening political atmosphere, staged protests opposing an anarchical factional and patriarchal system which they saw as characterized by indiscipline, disorganization, and laziness. The political dissidents and students appealed for more liberty and democracy but this

⁹³ Zhao Ziyang or Chao Tzu-yang: (October 17, 1919–January 17, 2005) was a great reformer in the People's Republic of China. He was Premier of the People's Republic of China from 1980 to 1987, and General Secretary of the Communist Party of China from 1987 to 1989. He quickened market reforms and achieved significant outcomes. But he was ousted by the CCP because he tried to eradicate bureaucracy and corruption in China. In particular, he supported the student demonstrators in the Tiananmen Square protests of 1989, during which thousands of students were killed by the CCP's Army. From then on, Zhao Ziyang was put under house arrest by the CCP until he died in 2005.

⁹⁴ The one centre refers to economic development, while the two basic points are: maintain the four basic principles (socialist path, dictatorship of the proletariat, the CCP's leadership, Marxism-Leninism and Mao's Thought) and continue with the policies of reform and openness (Deng ,1993).

is impossible in socialist China. According to Tocqueville (1848), democracy as an essentially individualist institution, stood in an irreconcilable conflict with socialism.⁹⁵ The current slow pace of the reform programme was leading to social instability. Hu Yaobang⁹⁶ was blamed for the protests and forced to resign as the CCP General Secretary who was a leading advocate of reform in January 1987. The CCP thought the demand for freedom was a demand for power and so found it impossible to tolerate this situation.⁹⁷

The reform of the economic system and economic situation was slowed down by the CCP until the 1989 Democracy Movement⁹⁸ broke out. However, this great Democracy Movement was eventually crushed by the CCP's army's tanks and bayonets and thousands of students and innocent townspeople were killed in this extremely tragic massacre. The government would not compromise. The regime does not know how to speak. It only roars, and roars plausibly (Gordon, 2002). As Leon Trotsky discovered: "In a country where the sole employer is the State, opposition means death by slow starvation. The old principle, which states who does not work

⁹⁵ Tocqueville said in 1848 that democracy extends the sphere of individual freedom, socialism restricts it. Democracy attaches all possible value to each man; socialism makes each man a mere agent, a mere number. Democracy and socialism have nothing in common but one word: equality (quotation from Hayek, 1944: 18.; also visit : <http://movermike.powerblogs.com/posts/1167680194.shtml>).

⁹⁶ Hu Yaobang: (1915-1989) The famous reformer of the Communist Party (CCP). After Mao, he was CCP General Secretary during the years spanning 1982–1987. He attempted to quicken reaction against Mao and to preside over a radical reform but he was dismissed in January 1987 for his relaxed handling of a wave of student unrest, the so-called "bourgeois liberty", in December 1986. In June 1989 he died and his death ignited the Tiananmen Square pro-democracy movement, which was eventually crushed by the tanks and bayonets of the CCP, resulting in the massacre of thousands of students (http://www.learntoquestion.com/seevak/groups/2003/sites/tiananmen/leftsidelinks/bios/hu_yao_bang.html).

⁹⁷ John Dewey, according to whom "liberty is the effective power to do specific things" so that "the demand for liberty is demand for power" (see "*Liberty and Social Control*", *The Social Frontier*, November 1935, p.41).

⁹⁸ The 1989 Democracy Movement (The 1989 Tiananmen Square Protests Tiananmen Square Massacre or June 4th Massacre or 6/4 Incident) was a series of student-led demonstrations held in Tiananmen Square in Beijing of the People's Republic of China, held between April 15, 1989 and June 4, 1989. The protest denounced China's economic instability and political corruption and was violently suppressed by the CCP regime (<http://9.douban.com/site/entry/11192447/>).

shall not eat, has been replaced by a new one: who does not obey shall not eat.”⁹⁹

After 4th June 1989, the CCP eliminated remaining sources of organized opposition, detained and arrested large numbers of protesters including many students and innocent citizens and put them into jails, then required political reeducation not only for other students but also for large numbers of party members and public officials. In the meantime, China’s economic reform was much slower under the Conservative clampdown than before but its society was in more chaos because of high inflation, corruption of civil servants and a drop in living standards. As a result, the CCP began to realize that the economy reform must accelerate in order to save their ruling crisis. Deng Xiaoping gave it new impetus when he visited southern China in early 1992. He emphasized that revolution means the emancipation of productive forces, and so does reform. The socialist market economy was the objective of China's economic reform. “Revolution means the emancipation of productive forces, and so does reform. The overthrow of the reactionary rule of imperialism, feudalism and bureaucrat-capitalism helped release the productive forces of the Chinese people. This was revolution, so revolution means the emancipation of productive forces. After the basic socialist system has been established, it is necessary to fundamentally change the economic structure that has hampered the development of productive forces and to establish a vigorous socialist economic structure that will promote their development. This is reform, so reform also means the emancipation of the productive forces.” (Deng Xiaoping, 1993: 63-64)

The proportion of planning to market forces is not the essential difference between socialism and capitalism. A planned economy is not equivalent to socialism, because there is planning under capitalism too; a market economy is not capitalism, because there are markets under socialism too. Planning and market forces are both means of controlling economic activity. For the first time in modern Chinese history, the

⁹⁹ L. Trotsky, *The Revolution Betrayed* (New York, 1937),p.76 (Hayek, 1976: 450).

nation's political leadership acknowledged that a link between socialism and the market economy was desirable. This represented a quantum leap forward in China's economic reforms and put forward the new chief judgment criteria about the road of capitalism or socialism.¹⁰⁰ Deng and his supporters argued that managing the economy in a way that increased living standards should be China's primary policy objective, even if "capitalist" measures were adopted. Subsequent to the visit, the Communist Party Politburo publicly issued an endorsement of Deng's policies of economic openness. Though not completely eschewing political reform, China has consistently placed overwhelming priority on the opening of its economy. The CCP clearly knew that they had no future if they did not implement a reforming path and develop their economy.

5.3. Establishing a socialist market economic structure from 1992 and the development of politics and economy between 1992 and 2004.

The turning point that established the market economic structure started from when Deng Xiaoping toured the south of China in January 1992, during which time Deng gave an important speech. The plans were established after going through three Party National Congresses, namely 14th (1992), 15th (1997) and 16th (2002) Party National Congresses (PNC).

- The 14th Party National Congress: this defined the establishment of a socialist market economy as the goal of economic restructuring in China and established the guiding position of Deng Xiaoping's theory;¹⁰¹

¹⁰⁰ The crux of the matter is whether the road is capitalist or socialist. The chief criterion for making that judgement should be whether it promotes the growth of the productive forces in a socialist society, increases the overall strength of the socialist state and raises living standards. (Excerpts from talks given in Wucheng, Shenzhen, Zhuhai and Shanghai January 18 - February 21, 1992)

¹⁰¹ Deng Xiaoping Theory: 1, the essence of socialism is liberating and developing productive forces, eliminating exploitation. 2, China was at the primary stage of socialism and would remain so for a long period that would last for at least a century and this stage could not be skipped. 3, We should continue to emancipate our minds, seek

- The 15th Party National Congress: this quickened the reform of state-owned enterprises so the reform of SOE could establish a modern enterprise system;¹⁰²
- The 16th Party National Congress: this fully acted on the important thought of the Three Represents.¹⁰³

The decisions of these Party National Congresses represented a great breakthrough in the theoretical reach of socialist economies (Gao, 1996: 1). As Hayek (1949) points out, socialists had to abandon the idea of a centrally planned system. They had to give up their hope and transfer their society to nearly equal a capitalist system in terms of productivity. The CCP believes that “the definition of the market economy is meeting the objective needs of socialized production and an internationalized market, and conceiving the market as an economic operation and form of management for an optimized allocation of resources. The socialist market economy is a market economy within the context of the socialist system, effecting the operation of market under socialist conditions and the socialist market system is the basis for the operation of the planned commodity economy” (Gao, 1996: 5). In fact, when foreign enterprises began to spread to China, they also created more space for non-state economic activity for

truth from facts, which is the essence of Marxism-Leninism, Mao Zedong Thought and Deng Xiaoping Theory, and constantly open up a new realm of Marxism, keep pace with the times and make innovations in a pioneering spirit, building socialism with Chinese characteristics. 4, Throughout the process of reform and opening up to the world, we must also adhere to the Four Cardinal Principles. 5, Reform is the power of socialism development. 6, One country, two systems: the motherland is socialism and Taiwan capitalism. 7, World peace and development are two major issues of today, and Deng stressed the need to establish an international political-economic new order and oppose hegemonism and power politics. 8, The CCP is the core leadership of the country. 9, China's modernization is to be realized according to objectives of the three-step strategy (Deng, 1993).

¹⁰² According to the requirements of “clearly established ownership, well defined power and responsibility, separation of enterprise from administration, and scientific management”, state-owned large and medium-size enterprises launched the normative reform to become market-oriented legal and competitive bodies. The reform reconstruction and management of the SOE should be made simultaneously. The SOE should be reorganized strategically to develop the whole national economy in a better way in order to manage the larger economy and help the smaller businesses (Zhao, 1999).

¹⁰³ Three Represents Theory or Jiang Zemin Theory: This was advanced in February 2000 when Jiang Zemin toured Guangdong province and was first presented as the nucleus of Jiang Zemin Theory. The theory focuses on the future role of the CCP as “a faithful representative of the requirements in the development of advanced productive forces in China, the orientation of the advanced culture in China, and the fundamental interests of the broadest masses of the people in China.” In a way, the “Represents” attempt to replace ideology with loyalty to the CCP without doing away with it altogether, and basically revolve around the need to identify the CCP as the moving force behind the reforms (*Three Represents Theory*, the Red Flag Press, 2002).

collectives and private enterprises. The overall balance between a planned and market economy gradually shifted in favour of the market.¹⁰⁴

In fact, on the road of a socialist market economy, people became inspired and rejuvenated as the establishment of a socialist market economy was promoted in all its aspects, which included economic structure and superstructure, ownership and industrial structure, value concepts and law construction, lifestyle and perspective. After the 14th Congress, under the building of a socialist market system, the main task was that large and medium state-owned enterprises would convert themselves and be able to compete in the market especially as it developed quickly, and that production should be connected with the market.¹⁰⁵ The Congress admitted that “it is difficult to step forward and tolerate overstaffed organs and an inefficient work style. As far as the leadership and membership systems of our Party and state are concerned, the major problems are bureaucracy, over-concentration of power, patriarchal methods, life tenure in leading posts and privileges of various kinds. A vicious circle has formed since the organs expanded after simplifying.” So the CCP advanced a positive political system reform and administration management system and constitution reform became the main subject of the 14th Congress. Political system and constitution reform is an important condition to deepen economy system reform and build a market economy system as well as the people’s pressing demands. But the CCP simply talked about doing this, rather than actually carrying it out. From then on, “although the system was euphemistically called ‘public ownership’ in reality it was privatization. In contrast to Russia, which moved directly from state industry to privatization, causing great disruption and hardship, China’s move to privatize came after almost two decades of development of the non-state sector, which would help ease the transition” (Goldman and Fairbank, 1999: 415). For example, the state

¹⁰⁴ Barry Naughton, “China’s Transition in Economic Perspective,” in Merle Goldman and Roderick MacFarquhar, eds., *The Paradox of China’s Post-Mao Reforms* (Cambridge, Mass.: Harvard University Press, forthcoming).

¹⁰⁵ The CCP set a high value on this decision: “All aspects of reforms originated by socialist economy reform would make historic change in China. 14th congress will be recorded in history by establishing Chinese socialism market economy system.” (The People’s Daily, 20th October 1992).

sector's share of industrial activity decreased dramatically from 78 per cent in 1978 to 42 per cent in 1996 and less than one-third in 1997.¹⁰⁶

In political system reform, the CCP still emphasized that a “democratically ruled constitution and Congress system of people are the achievement of people's struggling and the choice of history. This political system should insist and improve without following the pattern of western political systems which is decisive to the party's leadership, socialist system and people's democracy”.¹⁰⁷ Developing a socialist democracy and establishing a socialist political civilization are an important goal for building a well-off society in an all-round way. Adhering to the Four Cardinal Principles, we must go on steadily and surely with political restructuring, extending socialist democracy and improving the socialist legal system in order to build a socialist country under the rule of law and consolidate and develop its political situation so that it is characterized by democracy, solidarity, liveliness, stability and harmony.¹⁰⁸

A succession of careful historical studies of newly industrialized countries has shown that well-directed state action stepping in where markets failed was the main explanation for their success (Amsden, 1989; Chang, 1990; Deyo, 1987; Wade, 1990; White, 1988; quotation from Nolan, 1993: 223-224). The CCP reform first started in the field of agriculture in 1978 and the CCP went on to establish a socialist market economic structure in 1992 which up until today has caused a big change in China. The proportion of the labour force engaged in agriculture dropped from 71 per cent in 1978 to 56 per cent in 1993, and the proportion of gross industrial output produced by

¹⁰⁶ Wall Street Journal, April 7, 1997, p. A11

¹⁰⁷ Communiqué of 15th PNC claimed: The main tasks of political restructuring for the present and a period of time to come are to develop democracy, strengthen the legal system, separate government functions from enterprise management, streamline government organs, improve the democratic supervision system, and maintain stability and unity.

¹⁰⁸ Communiqué of the Sixteenth CCP National Congress (2002). The Red Flag Press.

state-owned enterprises (SOEs) declined from 78 per cent to 43 per cent in the same period. China's integration into the world economy has been equally dramatic: trade (export plus import) rose from 10 per cent of GNP in 1978 to 36 per cent in 1993, and direct foreign investment was \$28 billion in 1993 compared to \$2 billion in 1983 (Woo, Parker and Sachs, D., 1997:19) .

At the Third Plenary Session of the 11th CCP Central Committee, held in December 1978, the CCP decided to shift the focus of party work, starting from 1979, to socialist modernization, creating a policy of reform and opening up to the outside world. A series of key meetings were held, such as the conferences of the National Party Congress and Central Committee, and Deng Xiaoping's speech given when he toured the south of China. China attempted to move to a socialist market economy from its socialist planned economy step by step without any change to its political system. We can compare the situation from this table below. See figure 5.3.

The relationship between politics and economy in China

<i>Political Conference</i>	<i>Economic Reform</i>	<i>“Political Reform”</i>
<p>The Third Plenum of the 11th and 12th National Congress</p> <p>The 14th, 15th, 16th National Congress (1992--)</p>	<p>The planned economy</p> <p>To establish a socialist market economic structure (1992--)</p>	<p>The four cardinal principles</p> <p>To develop democracy, strengthen the legal system, separate government functions from enterprise management, streamline government organs, and improve the democratic supervision system</p>
<p>The Third Plenum of the 12th Central Committee, the 13th Party National Congress (1984--1992)</p>	<p>The creation of a planned commodity economy (1984--1992)</p>	<p>two basic points (1984--1992)</p>

When the reform was initiated, it called for a political reform. When the political reform was initiated, it called for an economic reform. When the economic reform was initiated, it called for a political reform. All the reform were decided upon by the CCP through its political conference. All the policies are made by the CCP. For China, politics determines the economy and the economy submits to politics.

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correctly use the force of history to make the Chinese economy strong and powerful (Chang, 2002).

In China, the CCP organization and members extend everywhere and control everything, but nobody has ever seen the CCP's financial records, only the financial records for the state, local governments, and enterprises. Both in central government and village committees in rural areas, municipal officials are always ranked lower than the communist members of the party, and so this means that municipal governments have to follow instructions from the communist party committees at the same level. The expenditures of the Party are supplied by the municipal units and accounted for in the municipal system. In fact, the CCP's reform and opening up policies disguise its intention to maintain its group interest and totalitarian rule. The Constitution, as revised in 2004, still rigidly states that "Chinese people of various ethnicities will continue adhering to the people's democratic dictatorship and socialist path under the leadership of the Chinese Communist Party and the guidance of Marxism-Leninism, Mao Zedong's ideology, Deng Xiaoping's theory and the important thought of the 'Three Represents (see p120)'..." (Communiqué of the Sixteenth CCP National Congress, 2002: 16). Reynolds (1985: 418) argues that "consideration of political variables bring us closer to an explanation of growth performance that we could get by looking at economic variables alone...For good or ill government seems central to economic growth" but building up a market economy system requires political reform and the conversion of the function of government because the market mechanism can adjust the allocation of material resources, and can also promote the rational flow of human resources. The reform of the political structure and the reform of the economic structure are interdependent and should be coordinated. Without political reform, economic reform cannot succeed, because the first obstacle to be overcome is people's resistance. "It is human beings who will - or will not - carry out the reform. For instance, we encourage devolution of powers, but other people take powers back. What can we do about it? So in the final analysis, the success of all our other reforms depends on the success of the political

reform” (Deng Xiaoping, 1993: 164).

According to Deng Xiaoping (1993), when the CCP first raised the question of reform the CCP had in mind, among other things, reform of the political structure. Whenever China moves a step forward in economic reform, the CCP is made keenly aware of the need to change the political structure. If the CCP fails to do that, China will be unable to preserve the gains it has made in its economic reform and its growth of the productive forces stunted. As a result, China’s drive for modernization will be impeded.¹⁰⁹ Although the CCP knew clearly that “if we do not institute a reform of our political structure, it will be difficult to carry out the reform of our economic structure”,¹¹⁰ it is impossible for the Party to do this as political reform would threaten and affect the interests of not only the CCP’s countless vested individuals but also the whole of the CCP ruling clique.¹¹¹ The CCP would lose its economic interests and political power if it took any step towards further economic and political reform after the development from 1992 to 2004.

5.4. The Achievements since Reform and Opening Up to the Outside World

¹⁰⁹ Deng said: “Our reform of the economic structure is going smoothly on the whole. Nevertheless, as it proceeds we shall inevitably encounter obstacles. It is true that there are people, both inside and outside our Party, who are not in favour of the reform, but there are not many who strongly oppose it. The important thing is that our political structure does not meet the needs of the economic reform. If we do not institute a reform of our political structure, it will be difficult to carry out the reform of our economic structure” (Remarks made on September 13, 1986, after hearing a report from the Central Committee’s Leading Group for Financial and Economic Affairs).

¹¹⁰ The contention often advanced that certain political measures were inevitable has a curious double aspect. With regard to developments that are approved by those who employ this argument, it is readily accepted and used in justification of the actions. But when developments take an undesirable turn, the suggestion that this is not the effect of circumstances beyond our control, but the necessary consequence of our earlier decisions, is rejected with scorn Hayek (1976: 59).

¹¹¹ The content of the political reform is still under discussion, because this is a very difficult question. Since every reform measure will involve a wide range of people, have profound repercussions in many areas and affect the interests of countless individuals, we are bound to run into obstacles, so it is important for us to proceed with caution. (From a talk with Yoshikatsu Takeiri, Chairman of the Central Executive Committee of the Komei Party of Japan, on September 3, 1986, the quotation from Deng Xiaoping, 1993).

Chinese economic reforms have undoubtedly been extremely successful in terms of raising production and enhancing incomes. Before the implementation of economic reforms in 1978 the Chinese economy was a centrally-planned economic system and this was the fundamental cause of China's economic stagnation. But when China carried out a set of economic reform policies such as household contract responsibility, implementing a planned commodity economy and a socialist market economy, huge changes occurred. In the period from 1978 to 1991, gross national product grew by 8.6 per cent per year, the annual growth rate of per capita income comes to 7.3 per cent,¹¹² which means that in the 13 years to 1991 the average per capita income increased by around two-and-half times. As Dwyer (1994: 13) states, "the growth rates of total and per capita GNP over the reform period are significantly higher than those for any 13-year period since 1952; high not only by China's own historical standards but also internationally. The GNP growth rates of 6 to 7 per cent per annum over a decade are exceptional, especially for populous and diverse economies."

The number of townships and village enterprises engaged in industry, commerce, transportation and construction increased from 1.425 million in 1980 to 1.59 million in 1988. The number of employees increased from 29.99 million to 48.93 million (Gao, 1996: 13). Even compared with other nations, during the first years of reform and opening doors to the world, for example, from 1980 to 1987, China's economic growth rate was not only higher than low-and-middle-income nations but also ahead of the advanced capitalist countries (see figure 5.4.1). China's average economic growth rate of GDP was 10.4 per cent, which was not only much higher than the 2.6 per cent of the 25 high-income countries and 3.4 per cent of the 15 upper-middle-income countries but also 6.1 per cent of 37 low-income countries and 2.1 per cent of 34 low-middle-income countries.

¹¹² Statistical Yearbook of China 1991, State Statistical Bureau, Beijing, p.31; Statistical Survey of China 1992, State Statistical Bureau, Beijing, p. 79.

Figure 5.4.1 Chinese economic growth compared with countries of different development levels (GDP and GNP)

Number of countries	Average of economic growth rate of GDP (1980-87) %	Per capita GNP (1987 dollars)
China	10.4	290
Low-income countries 37	6.1	290
Low-middle-income countries 34	2.1	1,200
Upper-middle-income countries 15	3.4	2,710
High-income countries 25	2.6	14,430

Source: World Bank, World Development Report 1989, pp. 164-9.

China's economy has seen a roaring growth since 1978 to 2004, with an annual average increase of 9.4 per cent. The following data illustrates economic development: in 1978 China's GDP rested on USD147.3 billion, and in 2004, over USD 1649.4 billion; in 2004 the total amount of China's imports and exports was up to USD 1154.8 billion compared with USD 20.6 billion in 1978; China's foreign exchange reserves also experienced a great increase from USD 0.167 billion in 1978 to USD 609.9 billion in 2004. The number of the impoverished population in the countryside dropped from 0.25 billion to 26 million (but the international organization estimate that still 0.15 billion live under the poverty line (<http://finance.sina.com.cn/g/20051020/08572048608.shtml>)).

We can more explicitly understand this change from the figures detailed below (see figure 5.4.2. below).

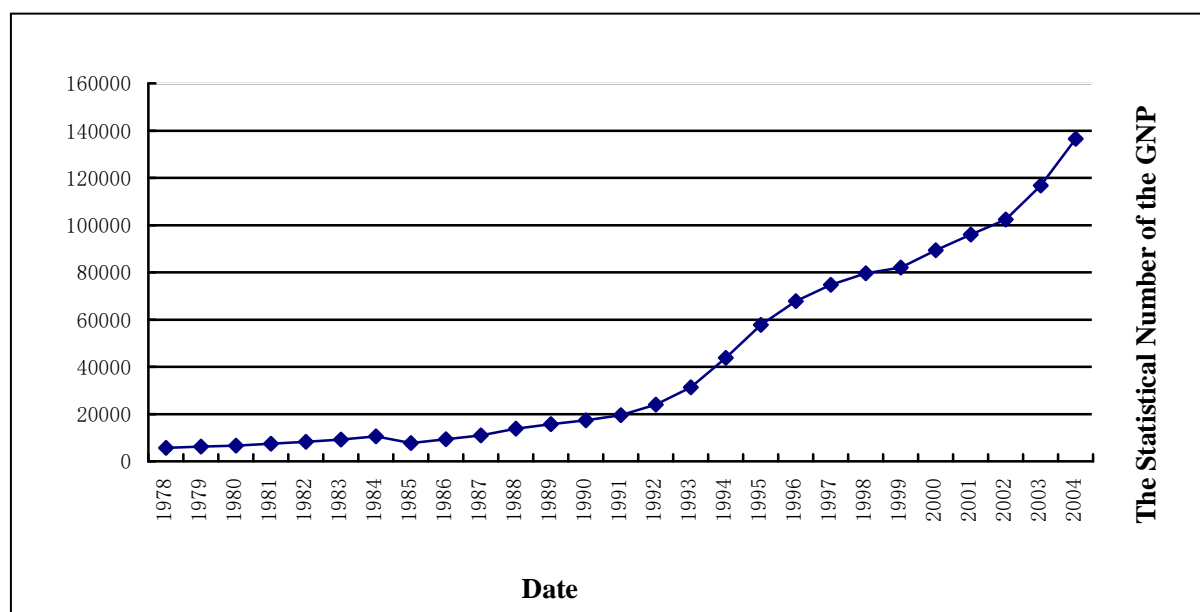
Figure 5.4.2.: Statistical Figures of the Gross National Product (GNP), 1978—2004. (Currency Unit: Yuan)

TIME	GNP	GROWTH RATE (%)
1978	5689.8	12.3
1979	6175	8.5
1980	6619	7.2
1981	7490	4.5
1982	8291	8.7
1983	9209	10
1984	10627	13
1985	7780	12.5
1986	9380	7.8
1987	10920	9.4
1988	13853	11.2
1989	15677	3.9
1990	17400	5.0
1991	19580	7.0
1992	23938	12.8
1993	31380	13.4
1994	43800	11.8
1995	57733	10.2
1996	67795	9.7
1997	74772	8.8
1998	79553	7.8
1999	82054	7.1
2000	89404	8.0
2001	95933	7.3
2002	102398	8.0
2003	116694	9.1

2004	136515	9.5
NOTES	GOVIA: Gross Output Value of Industry and Agriculture(1978--1984)	Growth Rate of GOVIA (1978--1984)

Sources: *China Statistical Yearbook (from 1978 to 2004)*, State Statistical Bureau of the People's Republic of China.

Figure 5.4.3.: The Statistical Figures of the GNP, 1978—2004.



Sources: *China Statistical Yearbook (from 1978 to 2004)*, State Statistical Bureau of the People's Republic of China.

It is easy to see the sustained growth in GNP and the stable growth from 1978 to 1992 when looking at Figure 5.4.1. and Figure 5.4.2. above. These graphs show that the GNP increased continuously from 5,689.8 in 1978 to 136,515 in 2004, and every year grew at a different speed, except a small drop after rising in 1985. The two growth rate peaks are recorded as 13 per cent in 1984 and 13.4 per cent in 1993 respectively, and two crucial points formed after the CCP initiated a commercial economy in 1984

and a market economy in 1992. It is also clear to observe a sharp rise from 1992 when the market economy was started (see figure 5.4.3. above). This also shows that economic transition plays an important role in economic growth.

The economic reform and opening-up policy is a long-term policy for the CCP in order to maintain its rule. At present, consumer spending is bouncing back as a result of a pro-active fiscal policy to fight off deflation. Many new sources of growth such as housing, education, and the IT industry are sprouting up throughout the economy. Promising prospects for future growth have made China the destination of overseas investment. As of July 2004, China had become home to a total of 353,704 foreign-funded enterprises coming from more than 180 countries and regions across the world. Nearly 400 of the world's 500 largest multi-national companies have established enterprises in China. The volume of contracted foreign investment exceeded USD 641.7 billion. China has utilized USD 327.7 billion worth of foreign funds (Hu Jintao¹¹³, 2004).

All these encouraging figures tell us that China was on the brink of another boom. As its reforms and opening-up continue and the modernization process picks up speed, China has offered more business opportunities to overseas investors. As Hussain (1991) points out, "Chinese economic reforms have been an outstanding success in three respects: first, economic growth; second, protecting the population from deprivation; and third, foreign trade and investment".¹¹⁴ China is a huge market with

¹¹³ Hu Jintao (1942-) was born in Anhui Province of China. Now he is General Secretary of the CCP Central Committee, Chairman of the Communist China, and Chairman of the Central Military Commission. Hu has no differences from other conservative leaders of the CCP and he has suppressed the movement of democracy and freedom, showing that the CCP still has no intentions for political reform. This quotation is from Hu, Jintao's speech in 2004 on Boao Forum For Asia – BFA in China. Hu's speech is: *China's 25-Year Achievement Of The Economic Reform Program And The Opening Up To The Outside World*.

¹¹⁴ See Athar Hussain "The Chinese economic reforms: an assessment" is a revised and abridged version of a lecture delivered at the East Asia Institute of Copenhagen University in December 1991.

great potential. To attract foreign investment, the Chinese government has redoubled its efforts in establishing the right environment for investment in terms of finance, taxation, foreign exchange, and service. Overseas investment has found enormous potential in such areas as agriculture, energy, information, infrastructure, and high-tech and environmental protection.

On the positive side of the balance sheet, the Chinese reforms have been remarkably successful on four counts: “first, accelerating the growth rate and sustaining at high level over a comparatively long period; second, transforming collective agriculture; third, spurring the growth of rural industry and household-based activities; and fourth, the expansion of exports” (Dwyer, 1994). To promote coordinated and sustained growth of the economy, the Chinese government has mapped out a cross-century plan to develop the vast mid-west region of China. This has offered tremendous business opportunities for investors both domestic and overseas. With China also joining the WTO, China is making amendments and additions to existing laws and regulations in compliance with the WTO requirements. China is increasing the transparency of its policy and management, further liberalizing its commodity and service trade, providing national rights for foreign business, and enhancing intellectual property rights protection. All these have been evidenced by more and more investment-friendly policies formulated by the government. China’s accession to the WTO is a win-win situation, in that both sides can benefit for China and the world.

Since the CCP came to power in 1949, it mainly concentrated on political and ideological leadership of the Chinese people and started a series of political movements. As a result of this, after the Cultural Revolution in 1966, the economy of the whole country nearly collapsed, which led to a crisis of the CCP’s leadership and the Chinese people began to seriously doubt the effectiveness of the CCP’s political rule and communism. The CCP had to start a reform of its economic system, which involved changing its planned economy to a market economy under the premise of adherence to socialist principles (also see chapter 4). In the early 1980s, China

adopted a three-step development strategy under the initiative of the late Chinese leader Deng Xiaoping. The target set for the first step was to double the GDP of 1980 by the year 1990 and to meet the people's basic needs for food and clothing. The second step was to double the 1990 figure by the end of the 20th century and ensure that the Chinese people can live a comfortable life¹¹⁵. The goals set for these two steps have been achieved ahead of schedule. Now, China is striving for the third goal(That is to raise the per capita GDP up to the level of those moderately developed countries, and basically achieve modernization and build China into a strong, prosperous, democratic and culturally advanced socialist country by the mid of the 21st century). However, these achievements and the official data above are obtained from the CCP's official statistics and information and should therefore provoke skepticism. The CCP may make any data stem from its political or economic demands and has absolute control and monopoly over all power and resources. For instance, Lardy (1998) thinks that China's official data overstates the growth rate by at least 2-3 per cent. Therefore, when looking at present-day China's comparative reform gains, one must consider whether the figures are overstated to promote politic aims, despite the acknowledged success of the CCP's economic transition so far.

5.5. The Key Reason for the Achievements of China's Reform is its Economic Transition

Before the implementation of economic reforms in 1978 the Chinese economy was a Soviet Union-style centrally-planned economic system that caused many problems. Under this socialist system, the rights of the disposal of property belonged to the government and its hierarchy. The government held significant power over the

¹¹⁵ It also set the economic goal for the period from 1981 to the end of this century, that is, under the prerequisite of constantly improving economic efficiency, to quadruple the annual industrial and agricultural output value of the country, i.e. from 710 billion yuan in 1980 to about 2,800 billion yuan in the year of 2000, so that people can enjoy a better standard of living. The congress also adopted the new Party Constitution. (Communiqué of the Twelfth CCP National Congress, 1982, the Red Flag Press).

management of human resources, product price and production and other areas. For example, the government was able to determine intermediate term investments and the allocation of crucial goods and input factors; long-run investment and related resource allocation; the assignment of personnel; and members of the hierarchy could determine daily managerial decisions. They believed that market socialism could allocate resources more efficiently than a capitalist system. All firms and means of production were owned by the CCP. The central planner was in charge of the managers of all state firms and these firms had to produce goods and services according to the government's demands, not the market. The managers of state firms have no incentive to maximize profits due to the lack of private ownership of firms, which can generate planning power and a great deal of tangible and intangible benefits (Friedman,1962; Hayek,1988). But such a system lacks any substantial change in the structure of property rights and so will create more problems than it solves.

When Mao led China, there was an absence of markets and private property rights, which was disastrous for China's economic development. However this generated a shock to central planning in China. For a long time, the CCP has exerted and rigidly centralized control of agricultural management. The people's communes were the rural administration, which was composed of different levels of state organization with political power at the grassroots level combined with collective rural economic organization. The egalitarianism and communal system seriously violated the principle of distribution according to work. The structures of the rural economy dampened the farmers' enthusiasm, hindered the development of the rural economy, and lacked vitality as well. As a result of the rigid hierarchical structure of a central-planned economic system, there is not enough incentive for economic development. The central planning authorities, working in the absence of a market, make it impossible to provide an effective incentive mechanism and the equilibrium that is achieved via a dynamic iterative process of central planning is inefficient

(Roland, 2000). For example, the centrally-planned system inevitably leads to economic stagnation, cost waste and inefficiency because workers have no creativity, initiative and incentives, and bargain of government-enterprises on quantity of materials allocated (Minami, 1994: 19). Most State-owned Enterprises are losing money and eating up the capital of China, and Restall (1997) estimates that “as many as 70 per cent of State-owned enterprises are losing money”.

After 1978, there was a gradual transition from the people’s commune system to “the household contract responsibility system” (also termed the household responsibility system or the rural families’ all-round responsibility system). In this system, all collective lands were contracted to families in the countryside. Families were able to make their own management decisions regarding agricultural production and take full responsibility for their own profit and loss. This responsibility enabled peasants to achieve self-managed rights of production and distribution which combined the peasants’ obligations, rights and interests, and overcame the disadvantages of the centralization of management and singularity of work mode. China’s success demonstrates the superiority of an evolutionary, experimental, and bottom-up approach over the comprehensive, top-down “shock therapy” approach of the transition in Eastern Europe and the former Soviet Union (Jefferson; Singh and Chen, 1992). In China from this point on, farmers were free to decide what to produce on their family plots. “Privatization” reforms proved to be successful for providing incentives, and are an efficient mechanism for encouraging high power incentives (see figure 5.5.1).

Figure 5.5.1. Rural Per Capita Income (current Yuan), Urban Cost of Living, Rural Cost of Living, and GDP (in percentages)

Year	Rural per capita income (current Yuan)	Urban cost of living	Rural cost of living	GDP
1978	133.6	1.9	2.4	12.3
1980	191.3	7.5	6.0	7.2

1985	397.6	11.9	7.6	12.5
1990	686.3	1.3	4.5	5.0
1992	784.0	8.6	4.7	12.8
1993	921.6	16.1	13.7	13.4

Sources: State Statistics Bureau, Statistical Yearbook of China 1994.

From Figure 5.5.1., the features of the rural income growth stand out. Almost all of the productivity growth was attributable to the changes resulting from the introduction of the household responsibility system (Fan and Schaffer 1991; McMillan and Zhu, 1989). First, the income grew very rapidly, and nearly trebled from 133.6 (income of per capita is 133.6 yuan RMB for one year) in 1978 to 397.6 (income of per capita is 397.6 yuan RMB for one year) in 1985. It shows how low both the Chinese level of rural income and production efficiency were and how fast was the increase in ten years. The second feature of the sharp increase in the urban cost of living, in particular the figures showing an increase from 1.9 in 1978 to 11.9 in 1985, and from 1.3 in 1990 to 16.1 in 1993, shows that at the beginning of the initial stage of reform and opening up, the peasants had the incentive, creativity and enthusiasm to produce due to the household contract responsibility system and also, the urban cost of living dropped from 11.9 per cent in 1985 (yearly per capita) to 1.3 per cent in 1990 (yearly per capita). The international society imposed tough economic sanctions on China because of the massacre of thousands of students and innocent citizens in the Democratic and Liberal Movement of 1989 by the CCP. These figures also show that the change in rural living costs was smaller than that of urban living costs. The reasons for this are that there is greater production and living standards in the city than that of rural districts. The urban economy is always the dominating force and potential of a State and so the figures of the urban living costs jump from 1.9 per cent in 1978 (yearly per capita) to 13.7 per cent in 1993 (yearly per capita). The GDP reached a peak of growth in 1978 (12.3 per cent), 1985 (12.5 per cent), 1993 (13.4 per cent), and the three subsequent years after showed an important change in economic transition. This was when the reform and opening up

policies were taking hold, with the market regulation as a supplement and the establishment of a socialist market economy. Once the CCP changed its economic system by political ways, the economy improved and GDP increased quickly. The figures from figure 6.3.1 proved again how the political system influences the economy in China. In addition, so low both cost of living in both city and countryside, and it also showed that people's life was very poor and the people are very thrifty because they have no the subsistence allowance unemployment insurance system; on the other hand, because Chinese population is too much and many families have 7 or 8 children so when the CCP rule China, especially during the abject poverty period of from 1949 to 1978, the cost of living of per capita nearly were very much low.

In 1984, urban reform which aimed to regulate industrial output through market forces was implemented and the government encouraged the formation of a labour market in its attempt to create a capitalist market. Estimates of the production function in several studies find that for industry the increase in enterprise autonomy increased productivity in state enterprises (Groves; McMillan and Naughton, 1994, 1995). After the transformation from a centrally-planned economy to a market economy, the share of all prices which were "free" or "floating" and the scope of mandatory planning was increased. For example, with the further acceleration and deepening of reforms in 1984, under the guidance of a socialist economy, the commercial economy system reform advanced quickly, especially in the cities. Clear progress was achieved in 1987, mainly on the condition that state ownership should uphold the public sector of the economy and expand and develop multi-economy sectors. Public ownership of the economy changed greatly in accordance with productive forces. Secondly, the methods of purchasing and payment for all products by state-owned enterprises changed and the operation rights of enterprises was enlarged through separating government functions from enterprise management and separating ownership from management. Finally, the range and method of Government macroeconomic control has been adjusted and improved through its reform of a planned management system.

Although China's government has improved its productivity, the profitability of its State enterprises has declined and the government's subsidies have increased due to a faster increase in wages, fringe benefits, and other unauthorized expenditures (Fan and Schaffer, 1991). The state-controlled industrial output decreased and private output went up by a large margin respectively (See figure 5.5.2.):

Figure 5.5.2. Distribution of national industrial output

1978		1987	
% of industrial output		% of industrial output	
State	81	State	60
Collectives	19	Collectives	26
Private	0	Private	14

Source: Xie Yichun and Coasta F. J. (1991) The impact of economic reforms on the urban economy of The People's Republic of China, The Professional Geographer, 43, 318-34.

It is easy to see that in 1987 private industrial output increased from zero to 14 per cent and the collective (rural industrialization) output increased from 19 to 26 per cent, which supports the government's aims of spreading the benefits of industrial growth into the countryside. In contrast, stated-owned industrial output dropped from 81 to 60 per cent over the same period.

There are two patterns of transition in former socialist countries such as Russia and Eastern Europe, and China. Russia and Eastern Europe's market-oriented reforms are just a small part of the transition of constitutional rules. China's market-oriented reforms have been implemented under communist game rules, that is, a one party monopoly of political power. Russia, Eastern Europe and China control all firms through keeping a low relative price of agricultural to industrial goods. Especially in China, the CCP sacrificed agriculture to support and develop heavy manufacturing, and used rural districts and their agriculture as sites for industrial raw materials. The Chinese government has purchased farms and sideline products at much lower prices

than the market price since the CCP came to power in 1949. In the meantime, industrial goods are always sold at a higher price than the market price. As a result, the farmer has nearly no purchasing power and become the victims of the market. This phenomenon was called the “scissors movement”, with the price of farms and sideline products being much lower than the higher price of industrial goods.

Capitalist institutions in developed countries have engendered a great variety of patterns in the division of labour which have subsequently been experimented with and proven to work in the market. The socialist imitation of all successful patterns of industrialization and the internal patterns of labour in capitalist firms was realized by destroying the capitalist institutional infrastructure that generated these successful patterns of industrialization and organization in a capitalist developed economy. In the absence of the capitalist institutional infrastructure, it is possible to carry out industrialization through the imitation of the industrial pattern created by capitalist institutions and possible that big push industrialization can be carried out by a socialist system that has no institutional infrastructure that is essential for discovering the efficient pattern of industrialization (Sachs, Woo and Yang, 2000). The strategy of imitating the industrialization pattern of capitalist developed economy, in the absence of a capitalist institutional infrastructure, can generate short-run impressive growth performance (Sachs and Woo 1994a). But as an initiator of a political economic system, Adam Smith (1776) showed in “The Wealth of Nations” where he analysed the impact of various systems on the creation of wealth, that a free trade system is more conducive for increasing wealth in any country than any other way. In effect, the success of China’s economy since its reform in 1978 was based on China’s imitation of the capitalist economy.

Under the course of the reform of a socialist system, the features of the dual track approach¹¹⁶ are an arbitrary and discretionary government power characterized by unfair,

¹¹⁶ This is a special phenomenon concerning the economic transition in socialist countries. The dual track approach means that there is a planned economy and a market economy in the same country. Any of several other

unstable, uncertain, and non-transparent game rules. Also, the dual track approach institutionalizes the arrangements wherein the government officials are the rule maker, the rule enforcer, the referee, and the player all at the same time. This is incompatible with the constitutional principle that they must be separated. The transition to fair, transparent, stable and certain constitutional rules is incompatible with the dual track approach, and state opportunism institutionalized by the dual track approach only leads to corruption (Roland, 2000: 43). As there were no effective checks and balances, the government and party apparatus hold a monopoly in all sectors of the government.

In addition, the economy has become far too reliant on exports and fixed investment. Depending on the metric chosen, these two sectors now account for between 70 per cent and 80 per cent of overall Chinese GDP. And they are still expanding collectively at around a 25 per cent annual rate (Roach, 2006). Foreign trade constitutes for China an important means of facilitating and accelerating its economy because China lacks the facilities to produce a wide variety of machinery and equipment which are urgently needed for industrialization. Thus, the Chinese economy would have grown much slower without imported capital, goods, materials and technology. Foreign trade has always been an integral part of national economic planning. The Chinese leadership is, in effect, conceding a very critical point on the sustainability of its all-powerful growth machine – that it has pushed the export-and investment-led growth paradigm to the limit. It fully recognizes the potentially destabilizing consequences of staying with this formula for too long—trade frictions and protectionism from open-ended export growth and excess capacity and deflation from open-ended investment spending. Without the solid underpinnings of internal consumer demand, China’s supply-side growth model poses mounting sustainability risks of its own.

When the CCP occupied mainland China in 1949, they inherited a largely

related or similar what is the planned price and market price. Normally, the market price is much higher than the planned price so it is easy for corruption to flourish because the officials can use the planned price for rent-seeking (also see Sachs, Woo, and Yang 2000).

underdeveloped economy. The productivity of the labour force was extremely low, with a low level of per capita income as well. Resources were very poor. In 1952, for example, crop area per head of rural population was 0.7 acres; per capita output of grain was 272 kg; railroads were 43 km per million populations; electric power generating capacity was 2.0 mill/kw; coal was 63.5 millions of metric tons; steel was 1.3 millions of metric tons; cement was millions of metric tons and cotton cloth was 4,158 millions of meters (Li Choh-Ming 1959)¹¹⁷. The low labour productivity in agriculture caused by an inadequacy of capital and abundance of labour kept the agricultural surplus at a low level. In slow years an inadequate supply of agricultural produce frequently became a major bottleneck in the development of industry. An effective central planning system has not existed in China, being paralyzed during a series of movements such as the Great Leap Forward and the Cultural Revolution.

China was very poor and largely rural at the start of its reforms. Agriculture employed 80 per cent of the work force and was heavily taxed to support industry. Social safety nets extended only to the state sector - about 20 per cent of the population. 18 per cent of the workforce was engaged in non-agricultural state enterprises, including state and collective farms, and the workforce were entitled to an “iron rice bowl” (guarantee job). Agricultural development required resources and investment as much as industrial development, however, the government was reluctant to divert scarce resources and funds from industry to agriculture. Agriculture contributes to economic development in many ways. It provides food for the urban population, exports to exchange for capital goods, labour and capital for manufacturing, raw materials for industry, and markets for industrial products (Galenson and Chen, 1969: 88).

As mentioned in chapter 2.3.2., the State and government play an important role in economic activity. In China, politics (the political power government of the CCP)

¹¹⁷ *The China Quarterly*, No. 12 (Oct. - Dec., 1962), pp. 234-239 (quotation from Eckstein, Alexander 1962).

hold 70 per cent of power over the economy and the actual economy only 30 per cent, that is to say, economic activity is not determined by the market but by the political demand of rulers. For example, as the social resources are controlled by the CCP, so all the quality standards, reduction of taxes, bank loans, investment projects, material supply, limitation of product prices and disputes among the enterprises are determined by the CCP government. The CCP's institutions and officials become the juggernaut and whole existence of an enterprise. China as a peasant agrarian economy had a poor infrastructure and an emphasis on local self-sufficiency led to low regional specialization and large numbers of small and medium-sized firms. Freeing it up had immediate payoffs. Yang, Wang and Will (1992) have shown that rural China was quite an autarchic society until 1978. The degree of commercialization (out of state control) was 0.3 per cent before 1978, although the first five-year plan developed a high level of division of labour in urban China by mimicking the pattern of the Soviet Union's industrialization. This meant that rural China could develop a high level of division of labour either through commercialization or through central planning. It is easy to develop a commercialized market system from a low level of division of labour. But it is extremely difficult to develop private property rights and related markets in an economy with a high level of division of labour initially developed through central planning. Reforms were easy in rural China because of a low level of division of labour. In contrast, reforms in urban China were more difficult because of a much higher level of division of labour established through central planning (see Byrd, 1983, 1991, Byrd and Tidrick, 1987, Perkins, 1988, and Walder, 1989; quoted from Sachs, Woo and Yang 2000).

China still had a great scope for the strategy of big push industrialization and imitation when it entered the reform era. The high income share of the traditional autarchic sector in China implies that it still had room to mimic the efficient pattern of division of labour in the capitalist developed economy in the absence of private property rights and a capitalist market. As Sachs and Woo (1994a) suggest, as the potential for the imitation has been exhausted or as the network of division of labour

becomes increasingly more complex, the long-run cost of this strategy will outweigh its short-run benefits since this system does not have an institutional infrastructure that can create its own capacity for economic development and institutional innovation.

When China started its transition from a planned economy to a market economy, the CCP did not have a well-designed blueprint. The approach to reform can be characterized as piecemeal, partial, incremental, and often experimental (Murphy, Schleifer and Vishny, 1992). The most important characteristic of China's market-oriented reforms is the absence of constitutional order and the rule of law. This implies institutionalized state opportunism, self-dealing by the ruling class, and rampant corruption. Corruption is associated with an evolutionary approach to reforms, which is a way to buy out the monopoly power of the privileged class. The common denominator of all these distortions to the reform process was the absence of the rule of law in government decision-making and executive authority. Procedures were ad hoc, non-transparent, and often corrupt. Civil society was too weak to offer important countervailing pressures, so that abuses went largely unchecked. In China, a very strong patronage relationship between government officers and private firms is essential for the survival of private firms (see chapter 4.2., 5.3. and 7.3.).

To sum up, China's impressive growth performance since the reform and opening up in 1978 can be attributed mainly to three facts: first, that it implemented a market economy instead of a centrally-planned economic system; second, the strategy of imitating the industrialization pattern of the capitalist developed economy and the opportunity for mimicking the new export-oriented industrialization pattern. Thirdly, a low initial level of development has made it easier for China to develop a commercialized market system.

In addition, China's impressive development performance is not only due to the potential for mimicking the old capitalist industrialization pattern. Also, a great

variety of social experiments in Japan, Hong Kong, Taiwan, South Korea, and other East Asian countries provide room for a new mimicking strategy. The newly industrialized capitalist economies provided free information on a new pattern of industrialization of labour intensive exports. This pattern exploits a significant differential in per capita real income between developed and less developed economies to export labour-intensive manufactured goods in exchange for capital-intensive equipment. Ethnic Chinese businessmen from Taiwan and Hong Kong bring human capital, entrepreneurial expertise, institutional knowledge, and capital, which are essential for the imitation of the new capitalist industrialization pattern, to China (Sachs, Woo and Yang, 2000).

Finally, we have to discuss how to treat the credibility of the development performance of China and the statistics. The first is the overstatement of development performance of China by some Chinese experts. As pointed out by Sachs and Woo (1999), China's broad growth performance is not better than the performance of other East Asian economies. Virtually every market economy in East Asia has grown very rapidly in the past thirty years, based on a strategy of rapid export growth of labour-intensive manufactures. During 1986-94, China averaged an annual per capita growth of around 5.6 to 6.8 per cent in PPP-adjusted GDP. Other East Asian countries also showed equivalent or even higher rates of annual per capita growth in PPP-adjusted GDP over the longer period of 1965-90, including: Hong Kong, 5.8 per cent; Korea, 7.4 per cent; Singapore, 7.4 per cent; Taiwan, 6.3 per cent; Indonesia, 4.7 per cent; Malaysia, 4.5 per cent; and Thailand, 4.6 per cent. In addition, the difference in per capita real income between China and newly industrialized countries, such as Taiwan, is still increasing (Sachs, Woo, Yang, 2000).

China's official statistics also overstate real growth rates too. Lardy (1998) shows that official data overstates the growth rate by at least 1-2 per cent. According to some Chinese scholars, such as Luo Shao (*Economic Highlights*, May 15, 1999, p. 1), the

official data overstates growth rates by 2-3 per cent. Also, Lardy (1998) provides evidence that the Chinese government purposely hides information about bad loans by state banks and the financial state of state firms. China's development performance is greatly inferior to what the official data indicates. Wolf (2002) shows that even if China's growth rates are much higher than Japan, Taiwan, South Korea, the US, and Germany, the difference in per capita real income between China and these countries will still increase before 2015 because of a very low absolute level of per capita real income in 1979 China. Hence, It must pay more attention to the absolute difference in per capita income level and its change than to the difference in growth rates.

What is the reason for the doubt concerning the Chinese government's statistics from academic research institutions and investment banks home and abroad? There are three reasons for this doubt:

The first is the shortage of experience and ability. China is still a developing country, and economic statistical data needs a long period of observation and accounting, which China is weak in.

The second reason for doubt is that it is hard to obtain reliable information. China is a large country with a vast territory and so relative statistics are hard to obtain and incomplete.

The third reason is that incorrect policies distort statistical data. Corruption is a part of all policies in the Chinese government. Whatever the central government desires, whether it be economic development or deflating the macro control, local governments will always find a way of manufacturing incorrect data in order to satisfy the needs of central government, and this will not reflect the true economic situation.

5.6. The Success of Reform is Short-term but the Harm Is Long-lasting

The CCP's insistence on keeping its one party dictatorship and safeguarding its group interests will cripple economic reform and has cost the country dearly. The rapid economic growth in the past 26 years is, to a large extent, built on the excessive use or even waste of resources, and has been gained at the cost of environmental destruction. A considerable portion of China's GDP is achieved by sacrificing the opportunities of future generations. Indiscriminate cutting of trees, levelling of rivers and filling of lakes have resulted in drastic ecological deterioration in China. Today, China's ecosystem is on the brink of collapse.

Since China's opening up and reform in the late 1970s, various problems concerning China's economy have gradually emerged in various business operations, from the macro economy to the micro economy, from market to society, from enterprise to individual. The contradictions in the long-term and short-term operations in China's economy can be regarded as an economic ailment arising from its pressing short-term operations. The economic definition for short-term operation refers to a short-term equilibrium existing in the economy while there is no such thing as a long-term balance. It is characterized as undertaking a short-term operation in various economic subjects without the sustainable development of the economy in the long run. The problem of China's short-term economic operations has showed that Chinese economic success is short-term but the harm is long-lasting. China's economy has suffered heavily from its short-term operations.

The short-term operations of China's economy are seen in many areas of society, including local governments, enterprises, banks and individuals. They all show obvious features of short-term operations. In space, economic operations do not have links among the market, society and nature, which brings trouble to the comprehensive development of the society, economy and nature as a whole. The sharp conflicts such as the disharmony between man and nature, economy and society are also revealed in economic development. In time, there are three breaking points in an economy. The first is that between the basic resources and productivity, which results

in the resource bottleneck in the economic development; the second is that between productivity and the total output, which leads to the divorce between the macro-economy and micro-economy; and the third is that between the total output and the basic resources, which leads to stagflation and possible economic crisis.

First of all, short-term operations make it possible for investments to grow too fast, resulting in a huge waste in economic basic resources. One of the prerequisites to the sustainable development of an economy is intensive management over the basic resources and the continuous enhancement of this management in the economic cycle. Basic resources include human resources, knowledge and technological resources and natural resources. All commodities are composed of these three basic resources, thus forming the foundation of the management value of economy. The short-term operations of China's present economy have resulted in an ineffective use of basic resources and the danger of exhausting these basic resources. For example, with conspicuous consumption, low economic results and huge discharge, the crude mode of China's economic growth has become a bottleneck restriction to the environmental resources. In terms of energy consumption per unit, in the eight industries including electric power, steel, nonferrous metals, petrochemical, building material, chemical, textile and light industries, China's consumption in 2000 was 40 per cent higher on average than that of more advanced countries. At present, China's energy consumption of GDP is 3 to 11 times as much as that of developed countries. Such a crude mode of economic growth has been occurring for many years. For more than 50 years since the CCP come to power in China, its GDP has increased more than 10 times while its consumption of mineral resources has increased more than 40 times. In 2004, China's energy consumption per unit was 2.4 times higher than the world average. To be more exact, it is 4.97 times higher than that of Germany, 4.43 times higher than that of Japan and 1.65 times higher than that of India.¹¹⁸

¹¹⁸ Outlook News Weekly, February 2005 (Chinese edition).

In addition, local government officials wish to achieve maximum results during their office term under the present system of examination, encouragement and restrictions. They tend to neglect the efficient exploitation of the resources and are always making full use of the basic resources. Thus local government officials are driven to make maximum use of the resources available, such as land and minerals in one term, in order to get the maximum return in the shortest possible time. In order to obtain taxes, some local government officials have sold farmland to foreign businessmen or real estate development companies at low prices. The imbalance between the cost and benefits and the short-term goals of the governments constitute the inner motives of the short-term operations by government officials, which cannot be solved through macro-economic control. Again, local government officials expropriate land from the peasants at very cheap prices and then sell it on to real estate companies at a price a dozen or more times higher in order to gain huge fiscal revenues.¹¹⁹ Revenues as one of the local official political achievements, in fact, once peasants lose their land they would get nothing beyond a little bit compensation provided by developers. These peasants have few transferable skills and find it hard to fit into urban life and so they have to join the army of the unemployed without any social insurance. The estate companies have mortgaged their land for a bank loan, so, in fact, it is up to the government to invest and develop the estate but in reality the profits flow into private pockets. In the meantime, the local government goes on collecting taxes and the farmers' lives become one of poverty and drudgery.

What is the embodiment and harm of the short-term operations in the main economy? The short-term operations can lead market operations, including enterprises and individuals, off the normal course, easily inducing an economic crisis in management. It shows itself in the following ways:

¹¹⁹ Wang Ha (2006), *China's economy is suffering heavily from its short term operations* (Shanghai Financial News, 5 August 2006; also see <http://www.china.org.cn/chinese/OP-c/1202362.htm>)

1. Short-term oriented enterprise: survival is vital for China's enterprises at the early stage of their development when they are not strong enough to compete in an uncertain market. The goal of many enterprises is to gain maximum benefits without considering their credibility and sustainable development, which bears the obvious marks of short-term operations. Thus there is a shortage of credibility in society and a tendency for the deterioration of the financial environment. At present, it is impossible for many Chinese enterprises to develop the concept of value management in the near future, which means the short-term operations of enterprises will prevail.

For example, China's discharge of polluted materials is quite copious. Nitric oxides per GDP unit is 27.7 times higher than that of Japan, 16.6 times higher than that of Germany, 6.1 times that of the U.S., and 2.8 that of India. Sulphur dioxide per GDP unit is 68.7 times higher than that of Japan, 26.4 times that of Germany, and 60 times that of the U.S. With its economic expansion, most of China's main water systems have turned out non-drinkable water. One third of the territorial resources have been eroded by acid rain. 60 per cent of 340 large and medium-sized cities are suffering from air pollution.¹²⁰

2. Short-term operations in the banking system. At present, banks are showing the tendency to carry out short-term operations under the pressure of providing a regular flow of funds. Individuals are prohibited to start a banking business (not including foreign banks) and all different types of bank belong to the CCP's regime. The party committee inevitably controls all banking operations and makes all decisions, for example, all the managers of bank are appointed from the top-down, and huge loan programmes and investment projects are operated by the secretary of the party committee. The short-term operations of banks have resulted in the excessive expansion of industries such as real estate. Banks are pouring great sums of money into the real estate industry, ignoring the needs of medium- or small-scaled enterprises and clients with good credibility in the countryside. This short-term operation results

¹²⁰ Outlook News Weekly, February 2005 (Chinese edition).

in the accumulation of great funds in the loan market while many small and medium-sized enterprises face a shortage of funds. These cases cause a distortion in the support from the financial sector to the economy. And because the banks only focus their funds on the most lucrative areas, this boosts a bubble economy and plants the seeds for a financial crisis (<http://www.jgsc.gov.cn/2006-5/200651085615.htm>).

3. Short-term operations of individuals. With the function of market mechanisms, people's individual behaviour is also characterized by short-term operations. It harms people's bodies and minds and will bring devastation to the natural environment and resources. Resources will not be used efficiently. Optimized productivity will fail to be shaped out of the basic resources which support the sustainable development. All this will result in the imbalance of supply management in the macro-economy and make the economic structure unreasonable. This may finally lead to an economic crisis in supply-type management.

4. Short-term operations in government behaviour. In recent years, local governments have sought only GDP growth under the pressure of performance examinations. They are expanding investments and increasing exports by whichever means possible. This is the important cause behind the present soaring growth in investments and exports. With the intervention of the short-term operations of the government, many investments are tied up with redundancy and projects introduced from abroad are also at a low level. It causes artificial prosperity in some industries, but the problems left behind are hard to tackle. Even macro control is unable to change the situation.¹²¹

The "curse of the latecomer" and economic disadvantages caused by shortsighted behaviors are causing a serious "crisis of legitimacy". The CCP carried out the policies of reform and opening up in the 1980s in order to maintain its rule. Its

¹²¹ Wang Ha (2006), *China's economy is suffering heavily from its short term operations* (Shanghai Financial News, 5 August 2006; also see <http://www.china.org.cn/chinese/OP-c/1202362.htm>)

eagerness for quick success has placed China at a disadvantage, termed by economists as the “curse of the latecomer”. The concept of the “curse of the latecomer”, or “latecomer advantage” as some other scholars call it, refers to the fact that underdeveloped countries, which started out late in terms of their development, will imitate developed countries in many aspects. The imitation can take two forms: imitating the social system, or imitating the technological and industrial models. Imitating a social system is usually difficult, since system reform would endanger the vested interests of some social or political groups. Thus, underdeveloped countries are inclined to imitate developed countries’ technologies (Sachs, Woo and Yang, 2000). Although technological imitation can generate short-term economic growth, it may result in many hidden risks or even failure in long-term development. It is precisely the “curse of the latecomer”, a path to failure, that the CCP has followed. For example, in the 18th and 19th centuries, Britain as an institution was a constitutional monarchy (implemented after 1688). However, France was still an autocracy, even after the French Revolution of 1789. Britain achieved better economic success, though, because it overcame state opportunism, such as the government contesting profits with private enterprises. In contrast, France still had a backward economy as it had remained an autocracy and its government had discretionarily violated property before the 19th century. Underdeveloped countries lag behind developed countries considerably in certain aspects and therefore imitate developed countries in a lot of areas (Sachs, Woo and Yang, 2000). It is easy to increase economic performance through copying and imitating technology and product and management models of developed countries, but underdeveloped countries only use technology imitation rather than institution imitation, which perhaps leads to an efficient economy in the short-term. In fact, the benefits from short-term development not only contain hidden trouble but also lead to a failure of long-term development. The curse of the latecomer allows many officials, businessmen attached to them, and their relatives and friends get richer and richer. The CCP has taken away thousands of lives, destroyed countless families and sacrificed the ecological resources upon which Chinese survival depends. The income gap between the urban and rural population has still drastically increased,

and economic disparity still continues to widen. These issues all stem from the CCP's curse of the latecomer.

5.7. Conclusion

The CCP recognized the failure of planning and the value of a market system and encouraged individuals to challenge the planned economy which allowed individuals greater economic freedom. China has made substantial economic progress since 1978. However, the CCP has been unwilling to abandon its vision of a “socialist market economy” and to perfect the market system. The CCP believes that without their firm guidance and survival, life in China would be chaotic and unstable, and the economy would grind to a halt. The CCP attributes its success to an “unswerving adherence to the Party's basic line”¹²² rather than institutional changes. “How absurd it is to judge relative performance by rate of growth, which is as often as not evidence of past neglect rather than of present achievement. In many respects it is easier and not more difficult for an undeveloped country to grow rapidly once an appropriate framework has been secured” (Hayek, 1976: 190). A lot of economic documents emphasize the importance of economic system reform and believe the reform is the precondition to keep the economic growth sustainable. In fact, these documents demonstrate the importance of economic system from another angle. An inappropriate system leads to the stagnation or low growth of the economy, while only system reform can relieve the stagnation.

At present, 18 per cent of the annual GDP of China has been produced by mortgaging the ecological environment and resources of the future. In other words, this part of GDP itself should not be included because it has been produced at the cost of

¹²² President Jiang Says China to Maintain Socialist Economy” and “President Jiang Calls for Another 100 Years of Communist Rule,” Agence France Presses, in Inside China Today, December 18, 1998. (<http://www.insidechina.com/china/business/news/98121801.html> and <http://www.insidechina.com/china/news/98121808.html>).

overdrawing the resources of the environment for future living requirements. If this calculation is accurate, the growth rate of the current Chinese economy should stop and even show a negative increase rather than an increase of 10 per cent. That is to say, based on the conditions of the resources and environment owned by China, many Chinese people have not enjoyed the material living standards seen in big cities such as Beijing and Shanghai. In the meantime, social conflict in China is intensifying and large-scale protests are frequent and repeated.¹²³ The communist party does not allow any opposition parties to exist. Without any supervision, there is no doubt that the party becomes arrogant, corrupted. Walking around the country, you will find thousands of local officials who regard themselves as the embodiment of absolute power. They levy tax at their will, execute the law and unbelievably, even issue their own currencies. This is seen in any city of China and rarely hidden. From any point of view, the Communist Party of China is losing its control. A new round of illegal land enclosures and seizure of monetary and material resources has driven many people to become destitute and homeless. The number of people appealing to the government in an attempt to have an injustice settled has increased sharply, and social conflict has intensified. Large-scale protests are frequent, which the police and armed forces have violently suppressed.¹²⁴

But various problems still exist, such as a huge population, a weak economic basis, underdeveloped productivity and unbalanced development as well as the comparatively conspicuous contradiction between the environment and natural resources and the development of economy and society and the conflict between the economic and political systems. It seems it will be impossible to reach the aim

¹²³ <http://news.eastday.com/eastday/node81741/node81762/node121716/userobject1ai1887467.html>;
<http://yydebbs.de/archive/index.php?t-2927.html>

¹²⁴ The Land Enclosure Movement relates to a dark side of the economic reforms of China. Similar to the industrial revolution in England (1760-1850), agricultural lands in today's China have been demarcated to build various economic zones at all levels (county, city, provincial and state). As a result of the land enclosure, Chinese farmers have been losing their land. In the cities, residents in older cities and town districts were frequently forced to relocate so as to vacate the land for commercial development with minimal compensation for the residents. More information is available at: <http://www.uglychinese.org/enclosure.htm>.

outlined by the CCP when they stated that “China’s GDP will reach USD 4000 billion, twice as much as that of 2000, and the GDP per capita will be USD 3000 in 2020”¹²⁵ It seems more impossible to “build a richer society, characterized by better economy, sound democracy, advanced science and technology, prosperous culture, harmonious life.”¹²⁶

Some of the major industrial and agricultural output in China has topped the world. The living standards of the Chinese people have been raised but China has not on the whole solved the problem of providing adequate food and clothing for 100 million people. The reform and opening-up policies have not resulted in the consolidation of the overall strength of China and the marked improvement of the quality of life of the Chinese people.

CHAPTER SIX

CASE STUDY ONE

6.1. Introduction

Institutional change impelled the development of China’s economic reform.¹²⁷ The first steps taken were “a spontaneous, unorganized, leaderless, non-ideological, apolitical movement” by farmers who resisted state coercion under the communal system (Zhou, 1996:4) and its spontaneous experiment with the “household responsibility system”¹²⁸ Further reform led to State-owned enterprises being guided by the game rules of the market and not the plans and demand of government. The

¹²⁵ The quotation is from Hu, Jintao’s speech in 2004 on Boao Forum For Asia – BFA in China. Hu’s speech is: *China’s 25-Year Achievement Of The Economic Reform Program And The Opening Up To The Outside World*.

¹²⁶ Ibid, see footnote 140.

¹²⁷ As Dorn (1998) points out, China’s economic success is due to the fact that its economic reforms have succeeded because some individuals were willing to risk everything to escape the iron grip of state planners and a life with no future.

¹²⁸ See Justin Yifu Lin, Fang Cai, and Zhou Li, *The China Miracle* (Hong Kong: The Chinese University Press for The Hong Kong Centre for Economic Research, 1996), pp. 132–33.

depoliticization of economic life has given people more time and energy to devote to everyday affairs, and economic freedom is essential for increasing human well-being. The reforms appear to be gaining hold and deepening, with many enterprises belonging only to the State in name.

But as China is a developing country and has a single-party rule, the reforms are defective, especially in protecting and specifying property rights. The structure of the current enterprise system in China has been sealed with the branding of history. Many state-owned enterprises in China bear the characteristics of bureaucracy. Most of the stocks of a listed company cannot flow freely in the market. Some enterprises labelled as state-owned or collective-owned turned out to be private undertakings. The realistic problems confronted by China's enterprises are closely connected with the development of these companies and influenced by particular social milieu in different historical periods. They are the dynamic results which have resulted from complicated historic events at different stages.

Some confusing problems have emerged with China's economic development since it began its institutional changes. Among them, the most distinct phenomenon is the ascription of property rights because at the early stage of the economic reforms in the 1980s, private enterprises were generally discriminated against. Therefore, for the sake of their development and for other reasons such as avoiding disturbance from authorized agents, namely, business administrators, tax collectors, quality conservators, many private enterprises became affiliated to a government department or other state-run enterprise and some went so far as to change into state-owned or collective companies in order to survive.

In addition, path dependence is still another problem. China has had a planning economy since the CCP took power, and its initial projects and choice of institutions copied the former Soviet Union. These institutions hold some "physical inertia" and still play a role. When China chose the path of a market economic system, some

special interest groups wished to keep the original path dependence and block further political and economic reforms. It is necessary to solve the problem of path dependence if China wishes not to follow the former wrong path of the Soviet Union.

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However, that the government specifies and enforces property rights is the first step for developing enterprises. The government did not permit private enterprise for a very long time for historical reasons and it has a number of policies and regulations to limit private sector development. Without any choice, those private enterprises have to cooperate with the Government and are anchored in the state-owned or collective brand of development. When they got the opportunity that allowed them to develop, both government and enterprises generated many disputes over property rights. Many problems led to failure because it is difficult to deal with them. For example, Li Jingwei is, like Yang Rong, quite typical. Li Jingwei was director of the Guangdong Sanshui distillery in 1983. Li Jingwei got a new sport drinks formula and introduced the beverage, giving it the name 'Jianlibao'. Owing to Li Jingwei's good management and marketing strategy, Jianlibao has become China's largest beverage company, which is known as China's Coca-Cola. Because enterprise property rights are too vague, Li Jingwei was arrested in July 2002 on charges that: 'As an employee who was entrusted by the State to manage and operate state-owned property, he defied state laws to devour the state-owned assets.' After several years, Li Jingwei was found guilty of misappropriation of state assets. Therefore both market and property are two core issues which inevitably have to be solved in order for private economic development to succeed. Private entrepreneurs maintain the principle of whoever invests, is who gains—a term of the corporation law.¹³⁰ Private entrepreneurs believe

¹²⁹ In the middle of the 1980s, a Japanese scholar, after visiting Chinese enterprises, reached a conclusion that enterprises did exist in China, which means that no typical enterprises which met the requirements of a market economy ever existed in China before the reform and open door policy were conducted. Speaking from this standpoint, the conclusion is reasonable (<http://www.japanresearch.org.tw/china/chinaresearch-108.asp>).

¹³⁰ The Law of Company (1999: 11). The People's Education Publishing House (Chinese edition).

they established their enterprises with their own money. The enterprises have grown bigger under their management and they have shouldered the risks of investment and management. The entrepreneurs therefore believe that the money thus made should be in their possession except for the duties they have to pay to the government. And here comes a problem: the government does not agree that the individuals possess the enterprises. Furthermore, once an argument about the possession of the enterprises arises between the government and individuals, the power of the state speaks, because the state not only legislates and amends laws, but also has more force in its possession.

In order to illustrate these problems, the incident concerning Yang Rong is a typical case.

6. 2. Yang Rong's Case

6.2.1. Hua Chen Group

In 1990, the entrepreneur Yang Rong¹³¹ borrowed 4 million RMB from his brother¹³² and registered a financing company, Hua Bo, in Hong Kong.

Yang Rong invested his money in China's newly founded stock market and made a fortune. At that time, the main approach to making money was to buy and sell stocks

¹³¹ Yang Rong was born in Anhui, China in June, 1957. He was awarded his Doctorate of Economy from the Southwest Financial University of China. He is the former Chairman of the Board of the Shenyang Golden Cup Bus Company, Ltd., and Board Chairman and President of *Hua Chen Group* of China. In 1995, his enterprise was China's first enterprise listed in the New York Exchange and was included in the USA's International Who's Who. Hua Chen's Stock Prospectus was valued as a typical case in Harvard textbooks, for it was the first company from a socialist country listed in New York Stock Exchange. At that time, the China Securities Regulatory Commission was not established yet. He left for the United States In October, 2002, China Liaoning prosecutors office approved an arrest of Yang Rong on suspicion of economic crime, because he had quarrelled with Liaoning Provincial Government about the latter's desire to take over Hua Chen Group.

¹³² His brother has been doing foreign trade business in Hong Kong for a long time and is a successful businessman. He therefore has the ability to provide financial support for Yang Rong.

on the newly-founded Shanghai Stock Exchange in 1991. Until 1992, Yang Rong made a lot of money from his seed capital and so he changed his company's name to Hua Chen Company Ltd., specializing in collecting loans for others and buying and selling bonds and stocks. His initial capital was accumulated during this time. Shenyang Golden Cup Car Company was reformed with the stock system, issuing ordinary shares worth 100 million RMB. Before long, an official from the Central Bank introduced the Golden Cup Car Company to Yang Rong, who immediately saw an opportunity and decided to buy, at the price of one yuan per share, 46 million unsold shares of Golden Cup Car in the name of the Hua Chen Group. Therefore, Hua Chen's from a start of 4 million RMB, Hua Chen is a typical example of how a company can grow by borrowing money in China.¹³³

Thus, the Hua Chen and Shenyang Golden Cup companies set up a joint venture—the Shenyang Golden Cup Bus Company Ltd. Hua Chen invested 12 million US dollars of cash in the venture, holding 40 per cent of the total stocks. The venture would manufacture the Toyota Sea Lion microbus by buying Toyota's permit.

Shenyang Golden Cup was in charge of manufacturing and running the operation while Hua Chen was in charge of financing. In 1992, 36-year-old Yang Rong had the idea to finance an overseas venture through stocks and put 40 per cent of Hua Chen's Golden Bus stocks into the US market. Su Guixiang, a top manager now, and one of Yang Rong's earliest partners, told the media when he was interviewed that in 1992, in order to realise his dreams of doing business in the United States, Yang Rong deposited his possession of Hua Chen China Stocks into a foundation. In September 1993, the Administration of State-Owned Assets of China supplemented a paper to approve it, asserting that in fact that it was an enterprise owned by the State in name, but by an individual in reality. The State had not invested a penny in the company in the past ten years, and the enterprise had not previously been contacted by any

¹³³ China Finance. 30th September, 2003 (Chinese edition).

appointed party members or been sent any official document from the government. Neither did the government audit Hua Chen as it did with State-run businesses. It was well-known in the Chinese business world that Hua Chen China was a private enterprise instead of a state-run enterprise. With Yang Rong's efforts, Hua Chen China Auto Holding Company (CBA) was successfully listed in Wall Street and it immediately was valued at 80 million U.S. dollars, 72 million U.S. dollars after subtracting the cost of dealing and retaining. Hua Chen's prospectus was documented in Harvard textbooks as a classic case and Yang Rong rose to fame overnight as a well-known businessman.

In November 1998, Hua Chen took advantage of the stagnancy of the Hong Kong Stock Market during the financial crisis, purchasing the business Huanle Tiandi, and renaming it Yuantong Science and Technology. In April of 1999, Yang Rong used his capital again and bought Shanghai Shenhua Industrial Company. SSIC and Shenyang Golden Bus signed an agency agreement of product vendition, thus entering the auto industry. In October 1999, Hua Chen Auto was listed in the Hong Kong Stock Exchange, raising 650 million Hong Kong dollars. This was related to the media by Yong Rong's intimate friend.

After this, Yu Muyan, the Senior Accountant of Hua Chen Group told the media that Hua Chen had successively invested 5 billion RMB in more than 10 companies in the auto industry, ranging from entire cars to spare parts and from distribution to service. Smaller subordinate companies included Hebei Zhongxin, which dealt in truck and cab production, Jinyang Xinchun, Shenyang Xinguang and Hangtian Mitsubishi, which dealt in engine production. All of these companies were ranked high in China's car industry. Purchasing 50 per cent of China Hangtian Car Company's shares, Hua Chen collaborated with France's Renault car company in a joint venture.¹³⁴

¹³⁴ This is confirmed by <http://my.cnd.org/modules/wfsection/article.php?articleid=964> (Chinese edition); http://big5.china.com.cn/zhuanti2005/txt/2003-01/11/content_5260103.htm (Chinese edition)

The Hua Chen fleet of companies created by Yang Rong has estimated net assets of 3 billion RMB after 10 years' development with an initial capital of 12 million U.S. dollars. The fleet includes three listed companies in mainland China: the Hua Chen Group, the Golden Cup Car company and Zhongxi Medicine; one listed company in Hong Kong: Yuantong Science and Technology; and one listed company in New York: Hua Chen China Auto Company Ltd. All of these five listed companies have formed the framework of the Hua Chen Fleet in the capital market and the total assets of Hua Chen Fleet's listed and non-listed companies amounted to nearly 30 billion RMB, which makes it a large business group.¹³⁵

6.2. 2. The Quarrel over the Escheatage of Hua Chen's Stock Ownership

Zhou Enlai and Kang Fangsha, two officers from the Development and Reform Commission in the government of Liao Ning Province said to the media when interviewed, that all this stemmed from the quarrel over the escheatage of Hua Chen's stock ownership. The key to clarifying the case of Yang Rong is to first outline the quarrel over the escheatage of Hua Chen's stock ownership and all the quarrels which originated from it. The Hua Chen mentioned in the disputed stock ownership of the case of Yang Rong refers to Hua Chen China Auto Ltd, which was listed in New York and Hong Kong with separate codes CBA and 1114HK. It will be called *Hua Chen China* for short in the following discussion. Hua Chen China Auto Company, Ltd. (CBA) is a listed company in Hong Kong and the United States. China Finance and Education Development Foundation owned by the China People's Bank—Foundation for short in the following discussion—holds part of Hua Chen China's stocks. The so-called stock ownership dispute is, in fact, a quarrel about the escheatage of Hua Chen China's shareholding of China Finance and Education Development Foundation

¹³⁵ This is confirmed by the Newspaper of Beijing Youth. 11th January 2003; Wangyi Business News. 10th December, 2003 (Chinese edition).

as a stock holder in Hua Chen China. As quoted from Yang Rong, 70 per cent of Hua Chen belongs to him. In the statement detailing the charge of Hong Kong Hua Bo Financing Company, Ltd. with Yang Rong as board chairman against China Finance and Education Development Foundation, the accuser stated that:

In February 1991, the accuser, Hong Kong Hua Bo Financing Company, Ltd., was registered in Hong Kong as a private limited company with registered capital of 10 million Hong Kong dollars. In July 1991, the accuser set up a joint venture, the Shenyang Golden Cup Bus Company Ltd., with Shenyang Golden Cup Auto Company, Ltd. and Hainan Hua Yin Trust Company, Ltd. In order to be listed in the stock market, the accuser set up a project company, Hua Chen China Auto Holding Company, Ltd. (CBA for short), in Bermuda at the beginning of 1992, holding 100 per cent of the stocks and investing in CBA company the accuser's shareholding in China Shenyang Golden Cup. Each party of the joint venture agreed to change their shareholdings in CBA into those of a foundation so as to be listed in the New York Stock Exchange according to its criterion, so in May 1992, the accuser, together with Hainan Hua Yin, the Education Department of China People's Bank and China Financial College, made plans to set up the China Finance and Education Development Foundation. Except for 100,000 RMB from the Education Department of China People's Bank, the rest of the capital came from the accuser's pocket. After this change, the controlling stock holder was, in name, the China Finance and Education Development Foundation. However, in fact, the foundation did not invest a penny in CBA and the accuser did not sign any legal stock transfer document with the accused. CBA Company was successfully listed in the New York Stock Exchange in October 1992. After this, the accuser successively set up the Shanghai Hua Chen Industrial Company, the Hong Kong Hua Chen Auto Holding Company, and the Zhu Hai Hua Chen Holding Company, Ltd. The three mentioned companies' shareholdings were also put under the China Finance and Education Development Foundation. But

the foundation did not, in fact, offer a penny.¹³⁶

For one reason or another, neither the accuser, Yang Rong, nor the accused, the China Finance and Education Development Foundation, had so far claimed their own investments and their own rights and interests. In March 2002, Liaoning Provincial Government ratified, according to its internal files, all the investments of the accuser and his rights and interests, as state property and embarked on an overall takeover. According to the accuser, the accused neither deposited any money in Hua Chen China Auto Holding Company Ltd nor involved itself in the business operations of Hua Chen China Auto Holding Company Ltd, so, by law, he should not enjoy the rights and interests of the investments in Hua Chen China Auto Holding Company Ltd. At the same time, the accuser admitted that it had invested and operated in the name of the accused, which played an active role in the development of the company, so the accused could have the rights and interests of the investments of a certain proportion, which should be confined to a lawful range.¹³⁷

Therefore, how much of his companies' assets does Yang Rong think should be in his possession? When being interviewed by journalists from the United States, Yang Rong said that: "70 per cent of the assets should belong to the investor; in this case, it should belong to me." According to Yang Rong's statement, he simply 'used' the name of the foundation in order for Hua Chen China to be examined and approved by the state and he proceeded with other business operations when he was preparing for Hua Chen China to be listed in the stock exchange. According to the principle of who invests, who gains, the foundation could have, at most, the rights and interest of 30 per cent of the intangible assets of the company.¹³⁸ Tian Jipeng, the Vice-General Manager holds this view as well, when the media interviewed him.

¹³⁶ Newspaper of Beijing Youth. 11th January 2003 (Chinese edition);
<http://my.cnd.org/modules/wfsection/article.php?articleid=964> (Chinese edition);
http://big5.china.com.cn/zhuanti2005/txt/2003-01/11/content_5260103.htm (Chinese edition).

¹³⁷ Ibid, see footnote 149.

¹³⁸ Times of Finance and Economics. 22nd December, 2004 (Chinese edition).

What happened at the time is explained by Sun Zhigang, who was a senior private lawyer of Yang Rong. He told the media that at the beginning, Yang Rong had intended to have his company registered and listed in his own name, but an investment bank suggested that his company should enter the United States market under the identity of state-ownership, for at that time, in Westerners' eyes, all enterprises in China were owned by the State. They would refuse to believe that a young private entrepreneur in China could have had such a huge business with so much money. He therefore could bring much trouble for himself which could lead to deep investigations into himself and his dealings if he had his company registered and listed in his own name.

The China Finance and Education Development Foundation in the prospectus was one made up by Yang Rong. The majority of the funds of the Foundation were raised by Yang Rong, too. This is because at the early stage when his company was being prepared to be registered and listed, Yang Rong invented the Foundation only at the suggestion from the Investment Bank and the Foundation did not involve itself in Yang's operation. Part of Yang Rong's investment was out of his pocket and some was loaned from the banks. The capital from the banks was borrowed in the names of Yang Rong's company and his relatives'.¹³⁹

Yang Rong told the American media that in 1992, he discussed with an investment bank how he could successfully list his company in the United States. He learned that if he wanted to have it registered and listed in his own name, experts from the stock exchange would wonder how it could be that he had had such a fortune at his age. To be listed overseas, it was necessary to show certificates from the bank and Tax Inspection Report. But before 1992, there was no such a thing as personal income tax in mainland China. Therefore, it was very hard for people to obtain these two

¹³⁹ This is confirmed by Asia Weekly. 10th September, 2004; 21st Economic News. 18th February, 2004 (Chinese edition).

certificates. As it was important for the image of his company to be listed, Yang Rong followed the idea suggested by his American lawyer and deposited shareholdings in the Finance Foundation. It was the only solution to the problem at the time.

The conflicting idea can be summarised thus: Yang Rong was a manager, in effect, entrusted by the State stock holders to run Hua Chen China.

Peng Dehuai, the officer of the Liaoning Province local government, and his assistant Si Maxiang, told the media that the Education Department of the China People's Bank invested 100,000 RMB and Hua Chen Group invested 1 million HK dollars when the China Finance and Education Development Foundation was established on April 29th, 1992. According to Yang Rong's supporters, Yang Rong is the chief stock holder of the Foundation according to the principle of corporation law — in that, whoever invests is the person who gains. But the spokesman from the Foundation declared that the Foundation is a non-profitable organisation instead of a company. Organisations only have sponsors instead of investors, and certainly not stock holders. Yang Rong did deposit some money when the Foundation was registered, but it was a donation of some kind. "The foundations receive donations of great value. Once donated, the assets become common property immediately and it has nothing to do with donators." Meanwhile, Huang Shiren, an official from the Enterprise Department of the Ministry of Finance told the media that "the Foundation — the bearer of the state capital - played a vital part in the start and development of the entire Hua Chen company. It won Hua Chen many preferential policies and support from the State and helped Hua Chen to obtain the loans it needed urgently. It did help Hua Chen to solve many problems and quieten many quarrels. It can be said that without the Foundation, there would be no Hua Chen today."

6.2. 3. Causes of Yang Rong's Departure

One reason for Yang Rong leaving China was the Ningbo Project and the project of

the bridge over Hangzhou bay. Ningbo Project is the first and sole joint venture of the British Auto Industry with China. According to the Sino-British agreement reached in early 2002, Hua Chen is entitled to selling, alone in Asia and most of Africa, different models of cars developed and designed by both sides. On March 21st 2002, the news was released in Britain that *Hua Chen Auto Controlling Company* and British MG - ROVER would set up a joint venture. It was reported that both sides had reached a strategic alliance, which included the present production in China of the Land Rover 25/45, joint efforts in developing a new Mini car, and the supply and manufacture of engines. It was said that according to this project, intermediate cars of the 25 series would be produced in Ningbo, China, and limousines of the 45 series in Britain. But the workgroup (the investigating group which polices the project in terms of its economic performance and potential) appointed by Liaoning Province decided that the project was neither rational nor valid, and so they stopped it going ahead.

Before long, Yang Rong had another intention to participate in the project of the Over-sea Bridge at Hangzhou Bay. The bridge at Hangzhou Bay is the longest over-sea bridge under construction in the world. It is located at the Yangtze delta, which is the most economically developed area in China. The construction of the Hangzhou Bay over-sea bridge is of great strategic importance to the economic development of the entire region around Hangzhou Bay. The bridge is a convenient expressway linking the main trunk circuits of the national highway to three other roads with the north starting point at Zhengjiali, Haiyan of Jiaxing city and the end point at Cixi Shuiluwan of Ningbo City, crossing the broad Hangzhou Bay. It is a speedway with a span of 36 kms and six two-way lanes and it is designed for a speed limit of 100 kmph. Its total investment was about 10.7 billion RMB and its designed service life is more than 100 years. After its completion, it will shorten the travelling distance from Ningbo to Shanghai by about 120 kms. The project was started in 2003 and will be completed at the end of 2008, being open to traffic in 2009. The construction of the Hangzhou Bay over-sea bridge is of great importance to the

regions around the Yangtze delta.¹⁴⁰ Yang Rong believed this project would bring a profit of at least 2 billion RMB to Hua Chen each year but the idea was aborted because of interference from the workgroup.

On March 31st 2002, some State departments became concerned about Hua Chen and issued an official document which set up a workgroup to take over Hua Chen's assets. It was decided that Hua Chen's stockholding would be taken over by Liaoning Province. Liaoning Province immediately appointed a workgroup in charge of checking, examining and taking over Hua Chen's assets. Yang Rong said that at the early stage of the takeover, he was quite cooperative. However, later he had opinions different from the workgroup because the latter did not permit him to invest in the projects of Ningbo and Hangzhou Bay, and this gave rise to his intense conflict with Liaoning Province. Yang Rong was afraid that he might be persecuted by Liaoning Province, and so he made plans to flee from China.¹⁴¹

Another reason for Yang Rong leaving China was that he suffered persecution. Yang Rong said that Liaoning Province Government grabbed everything it wished. Yang Rong claimed that the workgroup began to move against joint venture between Hua Chen Auto and BMW when the opinions of Yang Rong and the local government

¹⁴⁰ It is quite favourable for cities around Hangzhou Bay to have business links with Shanghai and further opportunities for opening up and development. This promotes cooperation and communication with the Yangtze delta areas, and advances the opening of the Yangtze delta area to China and abroad which helps to build up its integrated strength and international competitive ability. It is favourable to perfect the layout of the roads in the Yangtze delta area and main trunk circuits of the national highways, as this will reduce the traffic on highways between Shanghai, Hangzhou and Ningbo. This will improve the end point of Ningbo's traffic and change it into a hinge which will upgrade Ningbo's urban structure and realise the development strategy around Hangzhou Bay. It will also satisfy the needs of tourist development in Jiangsu, Zhejiang and Shanghai (Zhujiang Economy, Vol., I, pp. 60—63, 2003).

¹⁴¹ Forum of The World Handlers. 24th June, 2006, Duowei Times. 29th March, 2005; Taiwan News Weekly. 25th October, 2006 (Chinese edition); <http://my.cnd.org/modules/wfsection/article.php?articleid=964> (Chinese edition); <http://www.shszx.gov.cn/epublish/gb/paper4/5/class000400001/hwz597789.htm> (Chinese edition).

began to differ. Liaoning police also started to investigate Yang Rong's economic dealings, including claims that he was encroaching upon state property and had taken up to 500 million RMB. When he saw that he might get into trouble with the police, Yang Rong said, he left for the United States at the end of May 2002.¹⁴²

6.3. Analysis of Case

Luo Xinquan, an expert in business and administration, told the media when interviewed that, whether he was speaking to the department of state-owned assets or the foundation, Yang Rong never claimed that the company was his as he is an honest person, but the company could also not be said to be entirely the state's, either. The State did not invest any money in the company whereas Hua Chen provided 40,000 posts for workers and paid taxes of more than 1 billion RMB each year. Yang Rong expressed again and again that although the state had not invested any money in its name, it should be allotted some stockholdings.

This expert told the media repeatedly that “in China, political institutions hold 70 per cent of business, and the economy 30 per cent. Auto industry is a highly manipulated business, and so political institutions control more of this industry than other fields. Yang Rong had no idea of this situation in China.” Zhang Manni told the media. Zhang is Professor of Zhejiang University, and former Vice-President of Hua Chen China who worked with Yang Rong to disguise the Golden Cup's assets as that of the State in order for it to be registered and listed. Mr Wang Kang, the top manager of Hua Chen Group, said that “Yang Rong had been quarrelling with the Auto management up to the time cars were manufactured and turned out. He was quite ignorant of the policy guidelines in the China auto industry and the importance of public relations in the business. He neglected issues of this sort, so he gained little support from the government's policies. What made it worse was that he was quite arbitrary in cooperation with his business associates. Yang Rong became vulnerable

¹⁴² Ibid, see footnote 152.

when doing business as his financial operations were too arbitrary.”

According to the theory of state contract, the administrative power of the government is voluntarily provided by the society at their will. The people accept the existence of the government because they believe that the government plays a unique role in providing public services and promoting social welfare. Therefore, the people in the society endow, through formal or informal contracts, government departments with some disposable resources and certain privileges, permitting or even demanding them to exercise the constraining power or give necessary coordination and guidance for the sake of the common interests of the whole society. For example, people are willing to pay taxes to the government so that it can build public service facilities. People prefer to seek justice from the government if economic disputes arise between individuals or groups.

Knuttila and Kubik (2000) point out that power and domination can relate to a variety of active situations including economic activity. Political or state power influences social action in the context of a territory through the legitimate use of force. “We should protect private entrepreneurs” said Lin Guo, another famous expert who works in the business world, to the media when interviewed. “People with abilities like Yang Rong are quite few in China. He enjoys a world-wide reputation and has the ability to operate his business. The enterprise has enjoyed a market value of 20 billion RMB since it was established. He has turned an enterprise on the verge of bankruptcy into one with a net asset value of 3.2 billion RMB, paying tax of nearly 1 billion RMB each year. He has loyalty to the nation. He had the cars turned out and the enterprise saved from bankruptcy. He has done his bit for the country. Yang Rong tried his best to develop his enterprises, to solve some problems such as unemployment and pay his taxes but the government did not admit his individual right so he had no protection of the law and nearly lost his liberty.”

In China, individual rights and the law are not important, and instead they are constrained and controlled by the government holding political power. Sima Yi told the media when interviewed: “Hua Chen is a hen that can lay golden eggs but the Liaoning Government wants to deal with the Hua Chen Group by using political power. The reason is that the Hua Chen Group conducted its business according to the laws of the market economy rather than by the commands of the local government of Liaoning. For the Liaoning Government, it was not allowed to invest outside Liaoning province. In fact, the current Chinese private entrepreneurs never possess 100% property rights because any entrepreneur has to seek protection and support from the political forces of central or local government in order to develop their enterprises. The main reason is the vague property rights in force during the development process of Chinese private enterprise. In enterprise development, Yang Rong sought the help of government and he also paid any price including money, time and energy, and even personality and dignity. But Yang Rong himself also has shortcomings: he overestimated himself and he underestimated his opponent. For example, he lacked sober judgement and determination and was unwilling to pay a sufficient price. In contemporary China, no matter what you do, you have to be subservient to political power, and Yang Rong himself benefited from this substantially.” Hayek (1944) wrote in *The Road to Serfdom* that the similarity between various kinds of totalitarianism and other forms of government is that they all wish to direct the efforts of society towards the nature of their goal. But the difference between totalitarian governments and liberalism and individualism is that the former refuses to recognise autonomous spheres in which the ends of individuals are supreme and focuses only on organising the whole of society and all its resources for this unitary end. Only in times of liberalism was the rule of law consciously evolved and developed, being both a safeguard of liberty and the embodiment of freedom.

You Jianmin and He Luli, experts in the field of law, told the media that “Yang Rong started his business with the loans as his capital and made it grow bigger. During the

development, he borrowed resources from the state to have his business registered and listed abroad. Without the government's permission, he could not have had his company registered and listed. He should have had a clear division and separation of the profits he gained from the markets. But at that time, he did not divide the profits from the state nor separate his from that of the state. He said simply that all the company gained was from the state and the government said simply, too, that they should be under his management. He used the state resources of official seals, prestige and networking instead of money. The sticking point lies in that he did not divide up the property rights with the state as he could not divide it up at the time. If he had, he could have been finished or he could never have made it bigger until he went broke. Then nothing of the case could have happened. The trouble is that he made it bigger.”

The famous economist Yu Muyan told the media that “in the past, for quite a long period of time, especially at the early stage, those entrepreneurs always tended to develop the economy. They thought that if there is a good economic performance then the CCP perhaps has the economic ability to reform the political system. But in the very long term, the specification and enforcement of property rights was still being unclear and many entrepreneurs become very disappointed with this status quo. Their personal enthusiasm and passion were damaged by development enterprises which lagged behind in economic performance. But after the experience of high-speed development experience, the economic outcome has not been good due to the absence of clear property rights.”

In fact, China is still perplexed by the problem of path dependence¹⁴³ because the CCP is unable to extricate itself from the original path dependence. Once conflict occurred between the government and the individual or enterprises, the government

¹⁴³ Path dependence has a strong restrictive function on institutional changes. It is also a key factor affecting economic growth. If the right path is chosen, institution changes will proceed rapidly in a predetermined direction and arouse people's enthusiasm. The existing resources will be fully exploited to gain maximum returns, promote market development and economic growth, which, in turn, will become an important force to further institution changes. If a wrong path is chosen, institution changes are in favor of the privileged class instead of bringing universal increasing returns to people. As a result, institution changes of this sort will not gain supports from people. It will intensify the unfair competitions and give rise to disorders of the markets and the decline of the economy (North, 1991); see also chapter 2.2

still uses power to deal with it, not to mention providing a range of services which satisfy society. Individuals cannot use their knowledge for this purpose when they do not have freedom. “The most important of the public goods for which government is required is thus not the direct satisfaction of any particular needs, but the securing of conditions in which the individuals and smaller groups will have favourable opportunities of mutually providing for their respective needs” (Hayek, 1944: 2). Jacobson (1965) points out that when everybody works for the public good a person will still be used for himself. When an individual serves himself, he will serve the public, because the public and private interest guarantees one another and both of them will be as a whole and protected as well. Montesquieu (1949: 35) suggests that individuals still advance the public good, even while they think only of promoting their own interests.¹⁴⁴

Some people involved in this incident such as Qu Loupeng, the finance director, and Wei Xiaobao, the business executive of Hua Chen Group, told the media that the state did not invest any money when Yang Rong set up Hua Chen. But for one reason or another, he disguised his company as belonging to the State when he prepared for it to be registered and listed. A case such as this is not strange at all to those who are familiar with the situation in China, for there are many similar private enterprises disguised as those of the State. However, the trouble is that Yang Rong was not satisfied with this and did not let it go at that. He attempted quite a few times to justify the property rights of his private enterprise but failed. Wang Kang told the media: “Chinese governments at all levels have long been accustomed to ‘black’ case work and a lot of things cannot be done in daylight. Once local government behaviour is exposed to the sunlight, the local government's actions cannot continue to conceal some ugly things. Chinese officialdom’s general rule is: CCP’s officials are never

¹⁴⁴ In David Hume, *Treatise in Works* II, p.289: “I learn to do a service to another, without bearing him any real kindness”; and *ibid.*, p.291: “advantage to the public, though it not be intended for that purpose”; cf. also *Essays, Works* III, p.99: “made it not the interest, even of bad men, to act for the public good.” It occurs later in Josiah Tucker, *Elements of Commerce* (London, 1756; quoted from Hayek, 1976: 185-186).

afraid of any loss, they just care about personally liability and direct responsibility, and all this doomed Yang Rong to failure. Without question, Yang Rong is an ingenious strategist from a financial point of view, with the many ideas that he has continued using up till now. But he did not understand that private enterprise has always been the Government's subsidiary or complement; therefore, private capital has always been affected by its insistence on cooperation instead of competition. Yang Rong should have known that private enterprise is only supposed to supplement but not to replace or jeopardize the position of the government, in order to sustain development. Yang Rong's case showed that conflict is just a superficial sign of the problem between the political and commercial game but the essence and core of the problem is the ambiguous relationship of Hua Chen's property rights. If there had been a clear relationship between ownership and property rights, Yang Rong might have had joint shareholders and a board of directors to support him through their decisions. "In effect, although the 3rd plenary session of 16th CCP Central Committee pointed out clearly that property rights are the core and the object matter of ownership it clarified that the government is going to establish a modern system of property rights. It also raised some new policies to protect property rights of various kinds. This series of new theories might provide vital theoretical preconditions for deepening China's economic reforms.¹⁴⁵ But the outcome is hard to foretell. Hayek (1944: 59) claims that "similar considerations apply to the monopolies of rendering other services which government, mostly local government, can usefully render but which any monopolist is likely to abuse, indeed will probably be forced to abuse." From an impressive rise to self-imposed exile, Yang Rong's story illustrates that the representative of private ownership is no match in the end for the powerful state machinery if the escheatage of property is not clear. As Su Guixiang said to the media: "today the market economy is becoming globalized: any pattern of enterprise development must be carried out in accordance with the rules of the market economy

¹⁴⁵ The Third Plenary Session of the 16th Central Committee of the CCP Deliberated and Approved a Decision on Issues Regarding the Improvement of the Socialist Market Economic System. 11-14, October, 2003 (Chinese edition).

in China. The path of contemporary Chinese economic transition should respect the law in order to develop its economy. If enterprises only rely on the files of government from the beginning of reform and opening up to specify and enforce property rights, and if the behaviour of private enterprises and property rights concepts are not clear, how can private enterprises develop? China's economy is impossible to integrate into the world economy unless the issues left over by history are resolved during the period of reform and opening up.” The government will, sooner or later, clear private entrepreneurs out of their businesses. Perhaps if the same happens to other private entrepreneurs, many others will start moving their fortunes overseas. Private entrepreneurs are victims of these events initially but in the long run, the state will turn into the sufferer in terms of its economic development. Luo Xinquan said to the media: “the dispute about property rights between Yang Rong and the Hua Chen Group, in fact indicated that the socio-economic development in China has entered a new crossroads. The beginning of the reform of private enterprise left a lot of historical problems, for example, when private assets are expanding, property rights produced a lot of contradictions, so what criteria should be used to treat it? At the beginning of reform and opening up, the CCP stressed ‘letting some people get very rich first’, but now is it to continue to raise chickens or kill them for the golden eggs? In deepening the reform, how should it develop private enterprise and make a more relaxed environment for private enterprises?” “The creation and functioning of the state are tightly bound up with the protection needs of individuals and, later on, groups” (Barzel, 2002: 1).

Here, there is no independent sector providing similar public service instead of government or supervising, or arbitrating the disputes and issues out of control of government in order to mitigate the gravest danger of governmental action with all the powers and inefficiency of a monopoly. Cornuelle (1965: 50) claims that “it is most important for a healthy society that we preserve between the commercial and the governmental a third, independent sector which often can and ought to provide more

effectively much that we now believe must be provided by government.”¹⁴⁶ Hayek (1944) elaborates the rules of just conduct in two aspects: that conflict should be prevented, and that co-operation should be facilitated by eliminating some sources of uncertainty.¹⁴⁷

Analysis of the model-pattern of the four forces:¹⁴⁸

By applying this model, the media analyzed the four following forces: Government¹⁴⁹; Law and Common Norms; Social Members; and Enterprises in order to understand their roles respectively in present-day China (here, the concept of the State instead of present-day China temporarily, because a non-democratic government is just an existing regime which employs violent tools of management) and from this model-pattern of the four forces we can understand why institutional change is necessary in China now. There are four basic forces, which determine not only the

¹⁴⁶ Cornuelle (1965: 40) concludes: “If fully mobilized the independent sector could, I believe: 1). Put to work everyone who is willing and able to work. 2). Wipe out poverty. 3). Find and solve the farm problem. 4). Give everyone good medical care. 5). Stop juvenile crime. 6). Renew our towns and cities, and turn anonymous slums into human communities. 7). Pay reasonable retirement benefits to all. 8). Replace hundreds of governmental regulations with more effective codes of conduct, vigorously enforced by each profession and an alert press. 9). Handle the nation’s total research effort. 10). Turn our foreign policy into a world crusade for human welfare and personal dignity. 11). Leverage a wider distribution of stock ownership. 12). Stop air and water pollution. 13). Give every person the education he needs, wants, and can profit by. 14). Provide cultural and educational outlets for everyone who wants them. 15). Wipe out racial segregation. The independent sector has power to do these formidable things. But, curiously, as its strength has increased we have given it less and less to do, and assigned more and more common tasks to government.”

¹⁴⁷ Rules of just conduct are thus determined not by ‘will’ or ‘interest’, or any similar aim at particular results, but develop through a persistent effort (Upian’s ‘constans et perpetua voluntas’) to bring consistency into a system of rules inherited by each generation. (Hayek, 1944: 40)

¹⁴⁸ Note: Strictly speaking, the models in this thesis are merely an analysis framework rather than a mathematics analysis, and these models are only fit for the existing CCP’s institutions in China.

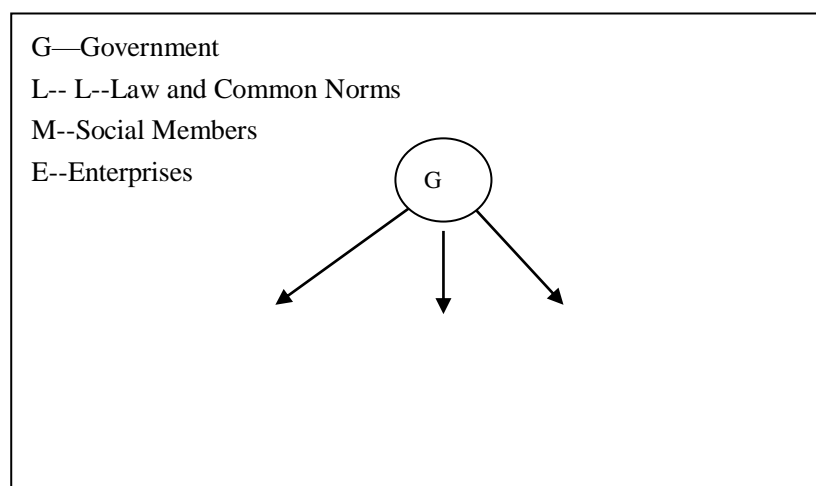
¹⁴⁹ The government here has a broad sense, referring to the existing Government at present, China (also called the “the CCP regime”), those social organizations and their staff, which are able to make direct use of the nation’s administrative power. Therefore, it includes not only people’s governments at all levels which have administrative power, but also various levels of Party organizations and institutions, People’s Congress, the Political Consultative Conferences, and military management systems and semi-government institutions.

changes of China's enterprise system but also government, individuals and ideology.

Barzel (2002: 4) defines the State as consisting “of (a) a set of individuals who are subject to a single ultimate third party who uses violence for enforcement and (b) a territory where these individuals reside, demarcated by the reach of the enforcer's power”. In reality, the administrative power stems directly from the manageable resources which are either taken through its force or given by the social members. These manageable resources include material resources, power resources, human resources, organization resources as well as others. Undoubtedly, institutional change is the outcome of various forces working together. The theory of system transformation believes that system changes are the results of government, social groups and individuals working together when system supply—demand analysis and system benefit—cost analysis are under consideration.

In China now, the relationship of these four forces is neither symmetrical nor equal. Their relationship is pyramid control, subordination and also one-way (see Figure 6.3a. below). Consequently, there is an unusual relationship between them. But the normal relationship should be that of Figure 6.3b., below; it is flat, equal and two-way. As Barzel (2002) puts it, the state possesses various tools with which it can promote contract trade, public roads, market and setting of standards.

Figure 6.3a. The unusual relationship of the four forces.



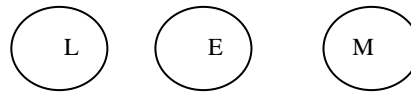
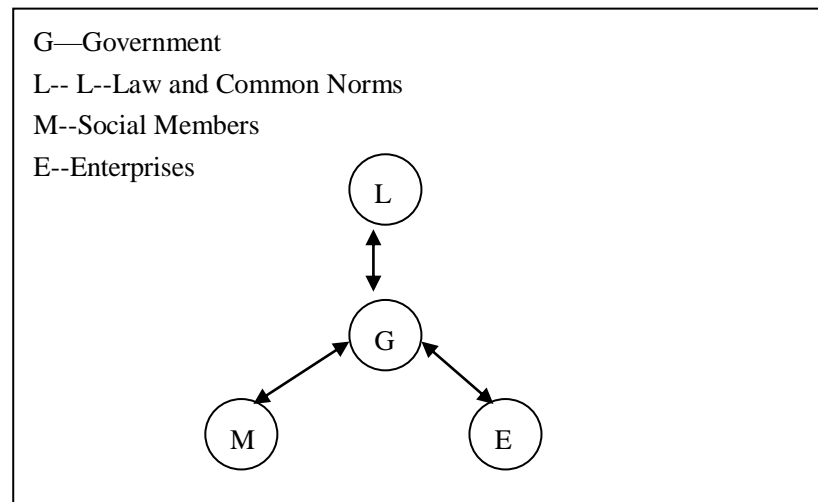


Figure 6.3b. The normal relationship of the four forces.



The CCP regime controls everything in China through three ways: commands, the use of resources, and one huge organization network:

a). Reserving economic resources which are accumulated through various channels: The CCP has a huge stock of reserved properties. They include natural resources such as land, rivers, minerals; fixed assets owned by government administrative departments, public institutions and public places; assets of state-owned enterprises; and the various financial funds in the form of currency waiting to be distributed. These economic resources are the important basis on which the CCP can exert its influence on economic operations.

b). Incremental economic efficiency by taxation: Taxation is the CCP's steady economic resource, which provides funds for the stable operation of the government. Besides this, the government can obtain more economic resources in other ways, such as levying fines, issuing treasury bonds, selling state-owned assets, and gaining

income from national assets operations.

c). A huge organization network: There is no country in the world which has a social organization network which can match that of the CCP's organization system. The CCP has established a criss-crossed, nationwide organizational network of social management at all levels of society through the CCP's party branches, agencies, youth members and controlled mass organizations. This network has a unique superiority in information dissemination and allotting of resources. The CCP's regime has a large number of staff which, through their specified duties and cooperation, keep the CCP in operation.

The CCP's regime acts on three other forces in different ways:

a). For law and common norms: According to Bluntschli (1895), the state lays down the law for society and protects society and and furthers its interests in many ways. On the other hand, society also supports the state with its economic and intellectual resources. However, the CCP regime does not draw up law and common norms on the basis of conventions or contract; it is favourable only for the CCP's rule. Only the CCP can make laws and common rules which have to be observed by the whole of society. The rules established by the CCP also have priority of enforcement above all the other rules made by any other organization or individual, which are not supposed to be in conflict with those enforced by the CCP. These laws and common norms always protect the CCP's special interests rather than the public. In the case of Yang Rong, the government did not protect the person who invests, but the person, or organisation, who gains—the principle of the Law of Company.

b). For social members: The CCP's regime has the right to determine whether social members can take part in activities and to approve or disapprove the behaviour of the members. Any behaviour that is ratified by the CCP, even if it is not in the public interest or in line with the law and common norms, can proceed smoothly as it has the protection and support of the Party. Any behaviour which is not ratified by the CCP

will face strong pressure from the Party and other organisations dependent on the CCP. The CCP has the right to reward individuals or organisations materially or with approval if their behaviour or actions are favourable or in the interests of the CCP. The Party can also punish people for disobeying CCP regulations even if they are working for social development. For example, if a person who has contributed to a charity wishes to track how his or her donation has been used by the Chinese government, the government will refuse the donation. In the case of Yang Rong, he had to flee the country when conflict occurred between him and the government.

c). For enterprises: Chinese enterprises have to operate with the government and cannot work within the framework of a functioning economy. The government will not destroy products which do not reach acknowledged standards of quality and will not punish enterprises which act in ways harmful to their surroundings or people. For example, a company which discharges polluted sewage will not be prosecuted if the enterprises operate in accordance with the government's wishes. The CCP has also transferred the rights of a certain piece of land to an enterprise or an individual at will, destroying thousands of historic sites in order to build entertainment centres, and the government can also provide the enterprises with funds for investment projects which they approve of them. In the case of Yang Rong, if Yang Rong had not asked the government to justify the property rights of his private enterprise and if there had been no conflict between the government and himself concerning the Ningpo Project and the project of the bridge over Hangzhou, the events which led to Yang Rong fleeing China would never happened. As pointed out by Barzel (1989: 107), "dictators are often averse to free enterprise and communist regimes' harsh treatment of 'profiteers' may be a case in point."

So, if it can understand the model-pattern of the four forces, it is easy to see why the incident concerning Yang Rong happened. In China, all the forces have a weak status and are passive. As pointed out by Hayek (1976: 128), "the effective limitation of power is the most important problem of social order. Government is indispensable for

the formation of such an order only to protect all against coercion and violence from others. But as soon as, to achieve this, government successfully claims the monopoly of coercion and violence; it becomes also the chief threat to individual freedom.”

From this case, although lessons might be learned about the government’s operations, government departments and state-owned enterprises will not invest any money in enterprises whose property rights are not specified and enforced. In addition, private proprietors must also be careful of cooperating with government or state-owned enterprises when there is no guarantee of property rights and law. However, this thesis only discusses the former. From this case it can also be seen that defective property rights will lead to an inefficient mechanism and a lack of incentive and power. Private enterprises could collapse without any protection of property rights and laws. Since the start of China’s opening up and reform, many private enterprises and entrepreneurs have slipped and been trapped in the pit of property rights, which are hard to differentiate from each other. A private enterprise will be on good terms with the government if it keeps its original size or even runs poorly or goes bankrupt. Once a private enterprise develops quickly, troubles about property rights will arise. The government holds that private enterprises enjoy its preferential policies, its material assets and its protection under the name of state-owned enterprises. All this should be valued as the government investment of its material assets. Thus, the enterprises’ assets will surely become property of the state and therefore under the control of the government. As a government, whose investors are not qualified, the government departments acting as investors play the dual roles of both investors of the national assets and the administrators of public affairs. The government should have ensured individual or enterprises a normal development and progress under the law.

This case of the entanglement over the property rights of Hua Chen is quite typical. It involves not only the definition of property rights, but the long-talked-about primitive accumulation of private entrepreneurs’ capital in mainland China as well. And last but not least, it involves local governments’ operations and path dependence. In short, the

key issue is institutional change. If justice is done in this case, it will lead the way for the further development of private enterprises in mainland China and help them out of the corner of financing. But the real result turned out contrary to our expectations. Yang Rong is still living in the US and has no right to return to China without being arrested. According to Bentham (1945: 59), “Liberty then is of two or even more sorts, according to the number of quarters from whence coercion, which it is the absence of, may come.”¹⁵⁰

According to the theory of property rights, these rights are efficient in solving problems of scarcity and competition, which fill the world with the lowest cost of the forms of property rights under the restriction of the existing technologies, information cost and future uncertainties. Competition will force inefficient forms of economic organizations to give way to efficient forms of economic organizations. As a result, people constantly make efforts to reduce transaction costs. Efficient property rights should be competitive and exclusive. Therefore, property rights must be specifically defined which will help to minimize the future uncertainties and possibilities of opportunistic behaviour. Otherwise, it will result in the reduction of arrangements of transactions and contracts. If the property rights are to be improved, this will increase willingness to commit resources to productivity enhancement. When these rights developed and enforced that will reduce incentives to free ride on the inventive efforts of others, it will encourage people invest in

¹⁵⁰ See also M. Schlick, *Problems of Ethics* (New York, 1939), p.149; Hayek, F. A. (1960), in his “The Constitution of Liberty”, London, Henley, Routledge and Kegan. p11. “The state in which a man is not subject to coercion by the arbitrary will of another or others³ is often also distinguished as “individual” or “personal” freedom.” F. H. Knight, “The Meaning of Freedom”, in *The Philosophy of American Democracy*, ed. C. M. Perry (Chicago: University of Chicago Press, 1943) p.75: “The primary meaning of freedom in society...is always a negative concept...and coercion is the term which must really be defined”; and the fuller discussion by the same media in “The Meaning of Freedom,” *Ethics*, Vol. LII (1940), and “Conflict of Values: Freedom and Justice”, in *Goals of Economic Life*, ed. A. Dudley Ward [New York, 1953]; also F. Neumann, *The Democratic and the Authoritarian State* (Glencoe, Ill., 1957), p.202: “The formula, freedom equals absence of coercion, is still correct...from this formula there follows fundamentally the whole rational legal system of the civilized world...It is the element of the concept of freedom that we can never give up” and C. Bay, *The Structure of Freedom* (Stanford, Calif.: Stanford University Press, 1958), p.94: “Among all the freedom goals, the goal of maximising everyone’s freedom from coercion should take first priority” (quoted from Hayek, 1960: 421-422)

finding new techniques of production. It is obvious that the technical change should more rapid if a better property rights system adopted, but non-institution would play their role (Menard, 2000). But because of the lack of commitment to private property rights, the future of investment is unclear. Modern anthropology confirms the fact that “the roots of property as a legal principle which determines the physical relationships between man and his environmental setting, natural and artificial, are the very prerequisite of any ordered action in the cultural sense” (Malinowski, 1944: 133). China must promote reform, and specify and protect property rights if it wishes to continue its rapid economic growth into the next century and not sacrifice its long-term interests, through wasting basic resources, destroying its environment and consuming excessively. As Justin Yifu Lin, Fang Cai, and Zhou Li (1996:226) argue, “It is essential for the continuous growth of the Chinese economy to establish a transparent legal system that protects property rights so as to encourage innovations, technological progress, and domestic as well as foreign investment in China.”

6.4. Conclusion

Institutions are a driving force for economic growth. For a long time, many economists would exclude the effect of institutional systems when analyzing or explaining economic growth. In other words, they prefer to take the system as a known or fixed arrangement. They owe the main reason for economic growth to technological progress, as well as human resources and knowledge. Institutions are constantly in a state of change. An economic system is constituted by many factors and the system is the link which connects these factors with norms in place to regulate their operations. In the operations of the economic system, each composing factor and the balance of their forces are in constant flux. In order to maintain a smooth and successful operation of the system, timely changes are necessary in various system arrangements, and these determine the constant changes of the social system arrangement. Lin Yifu (1993, 1997) further pointed out that there is a supply and demand of systems in social life. If there was imbalance between a system's supply

and demand, there would be a possibility of change.

Liberty is a State's highest good and for this reason alone ensures that property rights belong specifically to those who acquire them. In contrast, in conditions of slavery everything belongs to the rulers and not to the ruled. Property rights are the core of ownership. To establish the modern system of property rights with clear escheatage, defined authority and responsibility, sound guarantees and smooth and free transfer, it is favourable to safeguard the public and private property rights, in order to strengthen the principal status of the present market economy. It is propitious to protect private property rights and promote the development of the non-public economy; it is good for the flow and regrouping of capital of various kinds to ensure the economic development of mixed ownership. It is favourable for enterprises and the public to build up their drive to move forward and innovate. All this will lay a solid foundation for credit and establish a good market order.¹⁵¹ It is a requirement of humankind to perfect a basic system of economy. Practice shows that market economy, which serves as the prelude to the smooth and free exchange of economy, should have a clear escheatage of property right (Wang, 2004). The further developed the market economy, the more complicated the relations of the property rights and the more important the clear and definite escheatage of property rights. To establish and perfect the market economic system, we cannot, in any case, avoid and miss the barriers in the reform of the property right (Zeng, 2004). For Hume (1875), public utility requires that property should be regulated by general inflexible rules; and though such rules are adopted as best serving the same end of public utility, it is sufficient if the whole plan or scheme be necessary to the support thereby preponderating much above that of evil.¹⁵²

From the functions of the State, it can be seen that the power of the CCP is rooted in a

¹⁵¹ The Third Plenary Session of the 16th Central Committee of the CCP Deliberated and Approved a Decision on Issues Regarding the Improvement of the Socialist Market Economic System. 11-14, October 2003

¹⁵² See David Hume, *Essays* (London, 1875), vol.2, p.274 (quoted from Hayek, 1976:168)

violent revolution. The government's power has been snatched by the ruling class by force rather than offered by the governed willingly. That is to say, according to the theory that the State is a machine of violence, for individuals in society or groups, no matter whether they accept it, government departments can exercise their ruling force as representatives of the ruling class. The ruling group which governs the nation can use the state machine of violence, such as troops, police, courts, jails and administrative organizations, to force individuals and social groups to behave by certain norms or force members of society to act according to the rulers' will. Hayek (1976) claims that "There are, as we have seen, two distinct tasks included under it which must be distinguished: the enforcement of the universal rules of just conduct on the one hand, and, on the other, the direction of the organization built up to provide various services for the citizens at large."

In Yang Rong's case, it can be seen that when conflict occurs between individuals, enterprises and government, the public service providers ratified by the public use force as a tool to deal with the case. Heywood (2004) argues that the minimal role of the State is to provide a framework of peace and social order for private citizens. The role of the State is to reflect different views about the proper relationship between the state and the individual. It will be necessary to establish a democratic government according to the theory of state contract. If peace is to be preserved and quarrels to be prevented, the effective limitation of power is the most important factor for maintaining social order. All these have to change in the existing institutions in present-day China.

From Yang Rong's case, it can be seen that the historical changes of China's enterprise system at different periods are the outcome of the combined actions of various factors which are in constant flux and demonstrate different characteristics at different stages in history, raising different requirements to the change in the enterprise system. The common requirements of these factors for the enterprise system cause it to change along particular path dependence. "Freedom can be

preserved only by following principles and is destroyed by following expediency. If the choice between freedom and coercion is thus treated as a matter of expediency, freedom is bound to be sacrificed in almost every instance” (Hayek, 1976: 56). The CCP has chosen the socialist path since 1949, and it has path dependence for these institutions. Although the CCP is forced to take away itself from its established institutions, it needs the help of exterior forces or exogenous variables. As North (1981) puts it: what people decided on determines their present possible choice. Yang Rong’s case is in fact a course of institution changes and is a solution to the problem of path dependence. Its complexity determines the difficulty and slow movement of institutional change.

The media wants to take the original as the ending of this case study, which is from ‘An Inquiry into the Nature and Causes of the Wealth of Nations’ by Adam Smith, the great political economist and philosopher. This source is still of relevance, not only to the world of that time but also to present China.

“All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establish itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men .The sovereign is completely discharged from a duty, in the attempting to perform which, he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient :the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society. According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice

or oppression of every other member of it, or the duty of establishing an exact administration of justice; and thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain, because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society” (Smith, 1776: 545).

CHAPTER SEVEN

CASE STUDY TWO

7.1. Introduction

Chapter Six mainly discussed the ascription of property rights in present-day China. This chapter will discuss government intervention and monopoly. In China, sometimes, indeed frequently, government policies have had unintended consequences. For example, once private enterprises begin developing and making a profit, the government, however, thinks they are, in name and by law, state-owned, because their business licenses show that they are state-run and subordinate to the government. Their assets are state property by law. Therefore, the State will exercise

their power to rid most of the private enterprises of their owners and ensure their assets go to the government. This does not include the expenses apportioned by the government and administrative departments in charge, which pay for cars, office buildings, holiday villages, trips abroad and other projects of the government. Observers of Communist orders have long pointed out that economic organization and political power are defined by the party-state's bureaucratic control of resources¹⁵³ (Wank 1999: 5).

In China the abnormal social morphology is created by the strength of the market economy and political autocracy and it is very easy to lose balance with deep social contradictions that will suddenly break out. At present, the Government is in possession of political resources, judicial resources, and news resources, not to mention a small Dawu Group, even if the whole private entrepreneurial class is unable to resist it. Many of China's private enterprises operating in the mining area are affected as well: this phenomenon does not occur only in the Dawu Group. For example, look at Haitian events as well: on 22 November 2006, the president of the board, Wang Xitian, and several executives of the Haitian Industrial Co. Ltd., a chemical plant in Jilin province, were suddenly arrested because of fund-raising. All factories were forced to close and this even caused the death of a young member of staff because a policeman forced a machine to stop suddenly. Although the government temporarily closed the Haitian company, this was the time that the company went to the overseas stock market, which was the last key step. Tens of thousands of investors from all over the country voluntarily provided the final funds to go to stock market and made it a success although Haitian was without financial resources as the government had frozen company accounts. It can be seen that China's development bottleneck regarding current economic and social reform is the reform and construction of government itself. The government and certain groups of people always protect their vested interests and adopt whichever policies promote the CCP,

¹⁵³ Classic statements on this point are Djilas (1957); Feher, Heller, and Markus (1983); Rizzi ([1939] 1967); and Trotsky ([1937]1972).(Quoted from Wank,1999: 5)

putting their aims above Chinese people and national interest. In the meantime, the Chinese government frequently changes regulations according to their will and intervenes in the development of enterprises and the market economy. The State exists as one of three assumed regions of all formations (the economic, the cultural/ideological, and the political), whose functions are determined by its relations to the social whole (structural causality) (Aronowitz and Bratsis, 2002: 253). In China, the government is able to exert, at any time, national force to handle and appease voices and actions against it from different walks of life.

In order to illustrate this problem, Sun Dawu's case, discussed below, is typical of many.

7.2. The Case of Sun Dawu.

Hebei Dawu Farming and Stock Breeding Groups Ltd lies in Xushui county of Baoding city in Hebei Province. It was founded in 1985. At that time, the location was a stretch of orchard lying waste. There was a brick kiln and tens of grave mounds in it. The village asked for a bid of 6 yuan for each mu field. The houses were covered with asbestos shingles. The land was poor, the road was muddy and the vehicles available were poor. It was difficult to use water and electricity. In 1989, Sun Dawu resigned from his job at the Agricultural Bank. He bought this land and established Hebei Dawu Farming and Stock Breeding Ltd. After years of development and accumulation, it has become a large private enterprise, which includes a breeding industry, planting industry, processing industry, schooling industry, and tourist industry. The groups have seven subsidiary companies. These are the Dawu Breeding Fowl Ltd., the Dawu Feed Ltd., the Dawu Agriculture Planting Ltd., the Dawu Grape Wine Ltd. and Dawu High School. The Group employs 1,600 staff and there are 3,300 teachers and students at Dawu High School. The Group boasted fixed assets of over 100 million yuan and the value of output every year was over 100 million yuan. In 1995, the Group was appraised as one of the 500 biggest private companies in China by the

Administrative Bureau for Industry and Commerce. From 1994 to 1995, the company donated 100,000 yuan to fund teaching. In 1996, the company contributed water facilities at a cost of 40,000 yuan to the poor mountainous area in the region in order to help the poor. The company also invested 100,000 yuan in Jinpo village to help the villagers get out of poverty. Since 1997, the company has successively invested 1.6 million yuan in five kilometre concrete roads that allow over ten villages also benefit from the project. Sun Dawu, who is president of the Group, constantly promotes his corporation's culture, and pours new ideas and innovation into his organisation. His founding principle for the company is that it does not aim to seek profits but instead aims to pursue development and common prosperity in the long run (<http://www.sundawu.cn/english/about.htm>).

On May 29th, 2005, Sun Dawu, president of Dawu Farming and Livestock Group, was arrested by the local police for taking in public deposits without the government's authorization. The Dawu group had taken unlawful steps to draw public deposits in more than 10 offices set up by the group, from its employees and local community. The interest was higher than that of the banks but no tax had to be paid on the deposit. Until May 27th, 2005, the Dawu group had taken in public deposits of more than 35.26 million RMB from 4600 depositors. The police seized Sun Dawu, president of the group, and three other people directly responsible for this and held them under the authority of law. On September 30th, Xushui People's Procuratorate initiated criminal court action against Sun Dawu and his Hebei Dawu Farming and Livestock Group for illegally drawing public deposits. On October 30th, the Xushui People's Court sentenced Sun Dawu to three years' imprisonment with a four-year reprieve and a fine of 100,000 RMB.

7.3. Analysis of the Case

The media interviewed Mr. Zhu Jiuhu who defended Sun Dawu at his trial. In his view, Dawu Group's actions are in fact a lawful act of nongovernmental debit and

credit. Local people invested in the business to support its financing instead of providing a loan for it. Firstly, investment of such kind is reasonable. Serious analysis shows that the local people's investment was at some risk, but Sun Dawu kept his promise of repayment and they were able to draw their money back at any time, which ensured the safety of their money. Since they took this risk, they were entitled to get their corresponding return. Sun Dawu offered an annual interest rate of 3.3 per cent, which is a little higher than that of the banks and this also did not involve the same risks if they were to invest in other enterprises. Secondly, Sun Dawu sold part of his stocks to the local people to fund his enterprise. The investors would lose their money if the group suffered losses, but they would enjoy gains if the group made a profit.

Mr Wang Debiao, one of the barristers at Sun Dawu, told the media that the share of the investment was also practical. The state laws and rules do not oppose such a practice of share-investment. As it is a joint-stock limited company, Dawu Group is entitled to increase its capital by selling its shares. According to the Group's regulations, Sun Dawu had to explain to the investors where the money would go and the stockholders had their say about the company's operations, which helped to make the business more transparent and reasonable. Sun Dawu was the leading shareholder who had the final say. If other shareholders' interest is further guaranteed with the mechanism of shareholders' retreat from the business and the free redemption of their money when they are in urgent need of it, such an investment will be more appealing.

As Hayek (1976: 11) puts it, "Man is as much a rule-following animal as a purpose-seeking one. And he is successful not because he knows why he ought to observe the rules which he does observe, or is even capable of stating all these rules in words, but because his thinking and acting are governed by rules which have by a process of selection been evolved in the society in which he lives, and which are thus the product of the experience of generations." The administrative system of public affairs is made up of a series of government departments. The government is, above

all, an administrative system of public affairs. The functional departments of the government are also established according to this requirement. The ultimate objects of these departments are to guarantee the harmonious development of politics, economy, culture and other factors and to achieve the overall progress of society.

When the media asked Mrs Guo Li, Chief Finance Officer of Dawu Group, why the group did not ask for a loan from a national bank, she said that as early as 1995, Sun Dawu needed 6 million RMB to open up a grape yard of 1,000 Mu. When he asked the local bank for the loan, the president of the bank asked for 100,000 RMB in return. Sun got angry and refused the request. Dawu Group's applications for loans were denied since then.

Sun Dawu's assistant Xu Ming told the media that Mr. Sun was reluctant to bribe any officials and use unlawful means to gain favours and benefits. As a result, he offended some officials. The group refused to bribe the bank's president with a 10 – 15 per cent proportion of their loan and so was unable to obtain a loan. The farmers raised funds to help each other instead. Thus, how could such an act be labelled as illegal fund-raising? Wang Debiao chimed in with his opinion: "in fact, the means of Mr. Sun's arrest is ignoble as well: the Vice-Chairman of the Chinese People's Political Consultative Conference gave Mr. Sun a call and told him come to Hongyan Hotel for dinner with the new county party secretary. But when Mr. Sun came to the Hotel he did not see the county party secretary, only security police and plain clothes men."

In Zhou's (2002) opinion, the main part of the ownership development is the adjustment of the relations between the enterprises and the government. The instability of the enterprise development stems from unlawful regulations between the government and state-owned enterprises, with the relationship like "father and son" instead. The major confining factor in the process of the enterprise reform lies in the internal conflict of the dual identity of the government.

The group could therefore not obtain loans from the national banks while it needed capital to develop. In 1995, Sun Dawu came up with the idea that he could raise some money from his relatives and promise them a certain amount of interest with the due bills from the group. This model spread to the staff of Dawu. Of 1300 employees, more than 900 lent some of their own money to the group and they also introduced their relatives to participate. They then brought more depositors from nearby villages into the fund, which, in turn, expanded into a pool of 4,600 investors. The staff from the Group's accounts department was collecting more deposits while they were selling their products in the nearby villages. If anyone wished to deposit money, he could go straight to them. There were two kinds of deposit — current and time. The former is without interest and the latter has an annual interest of 3.3 per cent without interest tax deduction, which is twice as much as the current interest rate.

Hayek (1949, 1976) suggests that as a management system of public affairs, the government can exercise any means, including legislative, judicial, economic and administrative powers, to regulate the actions of all the investors and enterprises in society, and lead investors in a direction which is favourable to social development. Lin Yifu (1993) believes that system changes can be divided into two basic models: one is compulsory, which is pushed by the government and enforced by law; the other is the so-called tempted change, which takes place by itself when an individual or a group of individuals seek opportunities to gain benefits. According to the theory of state contract, politics and the economy are inextricably linked and government should play a positive role in society, not a negative role, adopting a series of effective measures to help enterprises through the superiority of their political positions and the allocation of resources at their disposal.

Mr Sun Dawu's other assistant, Gao Ming, told media that the South State-run rail company agreed to supply the company with perennial freight trains on condition that they paid 600 RMB per carriage to their manager. Mr Sun Dawu told the manager: "No way. I'll manage it if our workers have no jobs to do. We'll never do such dirty

dealing or be blackmailed. In my opinion, such dealings are as unclean as prostitution. The fact is that we are selling ourselves while we are selling our products.” Sun Liping, manager of the Poultry Branch Company of Dawu Group, told the media that one of their salespeople asked for 30000 yuan to bribe a state-run poultry farm in Beijing, as he had found out that other companies had been able to get one hen for 4 yuan instead of the 6 yuan the Dawu Group had had to pay. The seller is a state enterprise. It purchases more than 10,000 hens each time, paying 20,000 yuan more just because the group did not offer their manager extra money. Mr Sun Dawu said that he would rather pay more than bribe someone. Trading should be conducted fairly.

Mao Yushi (2003) points out that market economy should have give-and-take as its goal, which no one is supposed to go against. As different exchanges give rise to different conflicts, the government is obliged to redress the scales and maintain justice and normal person-to-person and business-to-business relationships so as to ensure regular trading by equal and free principles, preventing any privileged party from harming another party's interest. He points out that a government should not be privileged, otherwise market rules would be violated, and this would hinder economic development. The government's function is indispensable in the market economy, but it cannot monopolize everything — whether it is the government stepping in to lay a course for future economic development or setting limits for industrial development to conform to the market's laws or not is ultimately up to the market to decide. The government's intervention in the market has resulted in the lagging and imbalance of China's economic development. Behind each popular project, we can see the signs of the government's interference.

When the media interviewed Mao Yushi, he declared that it is unlikely that tough regulations and controlling measures will ever emerge, for the cost of these regulations would be an increase in the banks' bad debts as a consequence. Mr Mao Yushi maintains that from the case of Sun Dawu's illegal financing, we can see that the government's intervention in the economy and its monopoly of its finances no longer goes in line with the development of the market economy. China is expecting a good economic order and the chance to enjoy clean competition under the same rules.

Deng Miaofang, a freelancer, told the media that if the non-governmental self-raised funds are confiscated, local private enterprises might be paralyzed, for it is very hard for them to obtain loans from state-run banks. In western countries, private financing plays a vital role in their rapid development. These governments have standardised private financing. How is it that the Chinese government is trying hard to maintain the irrational finance monopoly so as to make it hard for the country to realize modernization? At present, there are so many projects under construction all over the country. How many are funded by individuals? The government is able to motivate the economy, but to our dismay, ordinary people fail to get rich. Without people becoming wealthy the country could not be said to be rich and powerful in the true sense of the word. That the United States is powerful lies in the fact that the American people are rich. Their planes, cannons and missiles are all manufactured by private enterprises and their best universities, Harvard and Yale, are private. Japan is a small country, but its total economic output is four times that of such a large country as China.

Mr Zhang Xian, a journalist from the Economic Forum, told the media that the reform of the economic system is the steady and regular transition from a planned economy to a market economy. A planned economy, in practice, is a government economy, power economy and supply economy. The object of the planned economy is to prevent the polarization society and promote a common prosperity. The planned economy called off free trading of the last thousand years. A market economy, in contrast, is a free economy, and a demanding economy. It is oriented by the market demand with free production and trading. The operators have to assume the sole responsibility for the profits or losses and at the same time shoulder the social responsibilities. From this narrow sense, the market economy can be understood as a capitalist economy, but from its broad sense and practice, the market economy is a public and working economy. It provides opportunities for everyone and in turn, everyone plays a role in it. The market economy and government economy obviously go against each other. A market economy is supposed to involve free trading and government should not come in between the sellers and buyers. In China, the government gets in the way of the economy. It is a so-called examine-approve

economy. Such an economy of examination and approval intensifies corruption at all levels and the downfall of social morality, forcing enterprises to bribe officials in order to gain profits. There are eight executive departments which can bully individuals, which are the Land Resources Bureau, the Water Conservancy Administrations, the Animal Farming Bureau, the Health Bureau, the Technological Supervision Bureau, the Industrial and Commercial Administration and the Taxation Bureau. Corruption results from an examine-approve economy with officials using their available power illicitly by law. Western developed countries, including Japan, have chosen to form free societies, which allow the growth of wealth and a powerful state, the most common approach adopted by developed countries. In contrast, underdeveloped countries usually adopt the road of a powerful state, governed by despotism which results in a poor society. Hu Yanglin, an expert on political systems, told the media that in China the difficulty in reforming the economic system is that political power governs everything. A market economy operating under political authority is inevitably an abnormal one. The obstacle to reform is that government departments hold power over the state above the law. The root of corruption in China lies in the fact that a monopoly governs industry and there is an examine-approve economy with law-making, executive and judiciary in one administrative department. Only when the economic system is reformed can China enjoy rapid economic growth. Such fields as education, medical care and health, land and finance should be open to investment from society. Individuals must also pay 5,000 to 10,000 yuan for an official stamp. If people wish to get something done, they often have to get licenses from as many as ten departments and in order to obtain a license people often have to bribe officials. The Chinese people hate the State's exploitation of production and capital through its power. Hu Yanglin said to the media: "in today's society, people can see many examples where success rests with local governments, and so do failures. For the government, 'success' means the right way to do the right thing; 'failure' means doing something wrong, which the government should not have done, or the wrong way and the wrong decisions. Many cases showed that failure is much more common, namely they did something that should not have been done. This involves the issue of transformation of government functions. Functions of the government have undergone great changes, but are still affected by the power of inertia in mindsets and behaviour. Some local governments are still doing superfluous things, which not only unnecessarily consume large amounts of public resources but

also influence the government to better focus on livelihood issues, which also affects the way people view the Government. Therefore, the Government is the same as other organizations: it must do the right thing. As for doing things the right way, we pin our hopes on the establishment and improvement of the government's democratic decision-making mechanisms." Wallis (1994) pointed out that politics can reflect people's worst values of selfishness, greed, divisiveness, fear and power. People long to see how politics could reflect people's best values of compassion, community, diversity, hope and service. The government still plays a large part in the economy and China has a multi-command executive system in which some of the functions of central and local governments overlap. The State is ruled by men rather than ruled by law as its legal system is far from complete. Laws are often violated by power-holders and some regulations are imposed without legislation (Minami, 1994).

Xin Xiaoqi, a civil dissident, the Young progress writer, he often writes radical articles criticizing the CCP's system and political and economic policies and he is always accused by the police of endangering public security and disrupting the socialist economy and undermining social stability. He told the media that an autonomous society containing non-governmental organizations is the trend of modern development. Conventions are the basis for laws. Something must be done to change the situation whereby society is exclusively run by the government. Society should be jointly managed by enterprises, leagues and citizens themselves and the role of professional associations should be highlighted. Reform is a kind of revolution, a safe one. It is to deprive those with vested interests of their privileges and unfair benefits. Political democracy, economic freedom and a social republic are the beliefs of the media and also the consensus of the Chinese people. Xin Xiaoqi continued: "political power does not belong to one person or a group of people but to the public in the modern democratic state and society under the rule of law. A large number of entrepreneurs often show helplessness when they touch this Gordian knot: I have no choice and I also hate the bureaucracy. I have to compromise with government officials and do dirty business in order to survive. It is impossible for a benign and healthy middle class to emerge because of the poor living environment which creates

a middle-class naturally dependent on political power. Once the middle class acquires property, they are likely to embrace or support authoritarian rule and also become the opposite of democracy. As ordinary citizens, we are in a time of change and we have the space to promote social progress. We have an opportunity through the gradual promotion of social progress. Sun Dawu's experience is a case of universal social significance. We helped Sun Dawu through the power of social morals; in the meantime, we are trying to promote legal institution changes in order to help him.” As Mises (1957) argues, a pure market economy assumes that government, the social apparatus of compulsion and coercion, is intent upon preserving the operation of the market system, abstains from hindering its functioning, and protects it against encroachment on the part of other people.

However, some people hold different views to this. Guo Jian, the Vice-Director of the Party Propaganda Department of Xu Shui County commented that common people usually fail to realize risks. If the operation of an enterprise did not go well, who would they go to for help? Everything is OK when the enterprise is operating smoothly but big problems will arise once its operation does not meet expectations.

Mr He Can, manager of the operations department of the local bank in Xu Shui County, said that Dawu's dealings made it nearly impossible for his bank to attract deposits. The loans made by banks are mainly mortgages. Banks' earnings from enterprises are limited and if therefore if Dawu's enterprise made a lot of money, it would not share these profits with the bank according to the government-defined fixed ratio. Only when the banks make sure that their money is safe will they be able to invest in enterprises. As banks obtain their money from common people, and so there is nothing wrong in banks being a little conservative. The practical new approach should be that shareholders invest their money in the Dawu group, purchasing machinery, setting up factory buildings and the group can ask the bank for loans against the security of all this. If they have a secured mortgage and the local bank still refuses to offer a loan, this is a different issue.

Sima Xiangru, the vice-president of the local bank of Xu Shui County, told the media that the fundamental way out for the financing of middle- and small-sized enterprises is to expand their direct financing. When thinking about the difficulty of financing for middle- and small-sized enterprises, most Chinese people would lay the blame on banks. However, even in the United States, where the market economy is highly developed, the five-year survival rate for middle- and small-sized enterprises does not reach 40 per cent, and the ten-year survival rate is only up to 13 per cent. Banks only get fixed interest, and so they usually refuse to run such a great risk. This accounts for the financing difficulties of middle- and small-sized businesses from the banks, which is an international problem. Guo Li said to the media: "Financing difficulties have been a real dilemma in the development of private enterprises. Finance is the lifeblood of business, and if the blood supply is cut off, enterprise is difficult to sustain. According to the statistical data of the National Bureau, 100,000 private enterprises went bankrupt in the first half of this year (2006) and this figure is likely to more than 200,000 at end of the year if we are not optimistic. At present, the amount of loans for the private enterprises has never exceeded 20% in China; private capital has encountered great difficulties in the financial markets. Chinese private enterprises took less than 20% of the loan, but created a 80% interest for country. This is at present fact.

The economist Wu Dawei also holds that on the part of the entrepreneurs, the greater the risks, the more money they would like to request from banks. For them, the cost of such financing is the low. Middle- and small-sized businesses all over the world complain about banks. But Wu Dawei maintains that when these people come to realize why the banks act in this way, they will not waste their time and energy. When they do not have enough funds for a mortgage, they are supposed to share their stocks with others. It is useless for them to hold 100 per cent of shares if their businesses are not fully developed. Xiong Junhong, a famous scholar, told the media: "China has not really set up a modern market economic institution that includes the financial system after nearly 30 years of economic reform. In the current huge financial markets, the

market share of finance in China's rural economy and private enterprises is still very small, and mostly based on the traditional private loans. But the state-owned and 'black' cases of bank lending accounted for a significant market share while for private enterprises in the existing legal framework there is not much room and legal space. Historically speaking, a modern financial and modern banking system originates from private or civilian lending. If the state develops the private economy or private banks, it should be on the basis of private lending."

Zhou Mingli, a professor from Henan University, told the media that as far as the policy makers are concerned, at the top of their agenda is how to smooth direct financing for middle- and small-sized businesses. In comparison with other countries, what China badly needs at the moment is a great number of specialized investment companies serving middle- and small-sized businesses. These businesses are able to collect money from the common people and in turn, seek out a promising middle- or small-sized business to invest in. Then they will share the returns from the business with the investors. As is approved internationally, great efforts are supposed to be made to develop investment venture companies and funds serving the middle- and small-sized companies in traditional industries so as to relieve their financing problems on a large scale in the shortest possible time.

But Yu Muyan told the media again that China is at a vital point in the process of reform. If everything depends on the government, China would slip back to the old planned economy. Many experiments can be carried out in society. Now China has many laws, which result in more limitations. Many officials are fooling with laws and cracking down on what benefits society. China needs reform and innovation but it is restricting people's creativity with much so-called standardization. This is a crucial problem. Everything is managed by the government at present. Li Zhiying, an expert in economy and law circles, believes that the difficulty in Sun Dawu's case is caused by the intervention from the government. From Sun's case, we can see that many departments in the government are actually oppressing units instead of serving ones.

If an old woman wants to sell a basket of her boiled eggs, she has to go to more than ten government offices for licenses before she is authorized to go to the market, or otherwise her business is said to be illegal. How can such an economy be developed? How can it be labelled as a market economy? Hayek (1976:158) states that a government acts “as a constraining force or non-constraining force possessed by the public service providers ratified by the public. According to the theory of state contract, the administrative power of the government is voluntarily provided by the society at their will. The people accept the existence of the government just because they believe that the government plays a unique role in providing public service and promoting social welfare to the maximum.”

Jiang Ping, professor at China Politics and Law University said, when the media interviewed him, that if Sun Dawu violated Article 176 of the "Criminal Law of the People's Republic of China", committing the crime of illegally drawing public savings, then this article is an evil law. An evil law should be modified. The law itself can be classified into good or bad. Mr Jiang divided the law into five categories: excellent laws come first. Then good laws come second. The third kind of law is stiff laws. Bad laws come after this and finally come cruel laws. Of the five categories, the first two show the real meaning of fairness and contain the principles of justice and the rule of law. They stand for the will of the majority and are laws in the truest sense of the word. The latter three are imposed by the authoritarian rulers on the majority. They are the wills of the tyrants instead of laws. We should always keep in mind and advocate such belief and commandments of the rules of law: bad laws are no laws.

Counsellor-at-Law Chen Ping told the media that there are three points to follow concerning loans. Firstly, borrowing and lending between companies is forbidden, for commercial lending is against the law. Secondly, enterprises are not licensed to borrow money from the public because this might give rise to illegal financing. It is impossible for one to borrow tens of millions of dollars from an individual. If you need such a sum, you have to borrow it from hundreds of people. This will then lead

to a financial institution in a disguised form, which is illegal. Thirdly, if borrowing and lending between individuals is not possible, then surely therein lies a trap. It is permissible if one borrows money from another when running into financial trouble. But when it becomes large scale borrowing, why is it that the government decides to interfere and prohibit this? Therefore, according to Mr Chen, China has to form some laws of governing investment and financing for private enterprises. Without proper rules and regulations, the Chinese government will greatly restrict its economic development. And what is worse, there people may be at risk of committing a crime unwittingly. What great bad assets are the four state large banks suffering? These banks are not prosecuted nor accused of any bad dealings. Sun Dawu had no bad debts and so why was he accused of disturbing the financial order? Why do those state banks with bad credits go on without being prosecuted? Zhang Baolai, a famous entrepreneur, told the media: “in fact, China's private sector and enterprises exist in an atmosphere of unfair competition. In 2005 the State Council issued Act 36 on the non-public economy, which allows private enterprises to enter previously prohibited industries and fields. The result is very disappointing: private enterprises are allowed to enter some industries and fields, but in fact, there is not any progress for private enterprises, at least, not in the fields of electric power, telecommunications, civil aviation, finance and so on because all these fields are basically being monopolized and controlled by state-owned enterprises. On the contrary, during the marketization reforms, private enterprises are excluded; a large number of strategic cooperation partners are foreign companies, such as large international investment groups, large international oil companies, banks, etc., so a big cake (namely, national interests) is shared with foreign enterprises.”

Professor Li Shuguang of China Politics and Law University told the media that he was greatly worried about the legal environment for private enterprises in a time of transition. It is generally believed that the private economy has been running into more and more difficulties since the economic reform began more than 20 years ago, because the critical point in the reform is focusing more and more on the private

economy, which is the main trend of the economic development. Now many problems exist. Firstly, there is no definition and protection of property rights in the private economy. Secondly, there is too much interference from the government in the development of the private economy. Thirdly, many private economic operations have been greatly limited and restricted in the present environment. China has failed to find an outlet for its pent-up creativity and broad possibilities, related to its existing environment.

Feng Yuanchang, Vice-General manager of the Dawu Group said to the media that although the group did not get authorization granted by the government to pull in money from local people as shareholders, it not only brought benefits to the local people, but development for itself and public welfare to the community as well. Even if people failed to pay their dues within the specified period of time, what is regarded as a poor operation, can be solved in that the company's assets can be distributed as shares which helps to turn the debtor into the creditor. Or if the creditors agree, they can spread the course of payment. People act according to the law. But what are laws based on? Laws are supposed to be based on social development. It should not be believed that without approval from the government, raising money from the public violates the law. You will be sentenced and put into prison if you go against the law. Only when our ability to operate is improved, can it play a better role in the development of capital market. Zhou Mingli told the media: "the motive for the government's supervision and management is to provide protection and help for the enterprises, which is a process of creating market order. But due to lack of experience, the CCP always sends officials into state and private enterprises to 'instruct' and 'manage' them and the enterprises lost autonomy and freedom of business operation in order to strengthen supervision. Since the CCP took over power prior to 1978, all the laws were designed to protect state-owned enterprises and revitalize the state economy. In the context of this policy, private enterprises do not have any policy support, personnel support, and technical support. Therefore, the development of China's private economy has a 'wilderness' character: some state-owned enterprises

and entrepreneurs get stronger and stronger through their own wisdom and ability to work together. However, in the process of the reform of property rights, it is hard to get along with the government and easy for the so-called political and commercial game to collapse, so it inevitably results in tragedy for some enterprises and entrepreneurs.”

Zhen Buzhu, Counsellor-at-Law of Dawu Group, said that there are countless people carrying out similar financing activities as Sun Dawu did. He is simply a representative of them. However, there is no efficient way to limit the development trend with a law as such. What Zhen wants laws which do not conform to social development to be modified. New ways and measures have to be adopted to regulate people's finances. Pioneers in the course of development are not supposed to be brought to judgement with out-of-date laws. It is known to all that the majority of ordinary enterprises and individuals are unable to raise money outside their remit without approval from governments. Only a few people who have a close association with high officials enjoy the privilege to set up financial institutions with the approval to collect funds from society at large. Therefore, social funds are in the possession of a few financial groups. The majority of enterprises and individuals have no way to get funds but it is them who are in urgent need of financial support so as to survive in such a society and competitive time.

Xiong Junhong told the media that if what Sun Dawu did is illegal financing, then hundreds of thousands of people are also doing the same. What Sun did is not uncommon in China today. If we conduct serious investigations, few large- and middle-sized state enterprises will be exempted from punishment for their illegal actions. It is a simple fact that the financial market in China is not regulated. It is very hard for private enterprises to raise funds through legal ways. Even with the help of banks, these enterprises have to do this under the counter, so to speak, which is common practice in China. Therefore, whatever approach Su Dawu followed to raise funds would go against the law and he would surely be prosecuted eventually.

Although the development of the private economy is helpful for the circulation of commodities and taxes for the government, the law enforcement officials themselves will gain fewer returns from it. It is their self-interest gained through their power that has driven them to enforce administration and laws.

Liu Anhui, a Doctor of Law, when interviewed by the media, maintained that China's legislation should have formed good laws showing solicitude for the people's livelihood and aims to reduce rigid laws of administration and intervention from the government. Lawmaking should encourage free competition and bargaining. Zhang Baolai told the media again that, in recent years, there have emerged countless cases where administrators and law enforcement officials have deprived people directly of their wealth. There is often news of political powers ruining China's economic development, the current characteristic of political corruption. For instance, over 1000 private petroleum enterprises have been nationalized, which has forced dozens of private enterprises with hundreds of millions of wealth change hands overnight or be confiscated or their management shifted to the state. Property privatization, public power popularization, and information diversification is the essential element of economic development. Private enterprises are rising to the mainstream position of China's economy. But private enterprises lack the protection of good institutions and always produce friction with government departments. Because of Sun Dawu's great popularity, this situation impels tensions to explosion point. In China, all economic, cultural and social rules have the heavy imprint of political system and all economic behaviour also can be determined through political way. On the one hand, the private enterprises in the Chinese mainstream economy are still subject to discrimination and still inhabit the edge of the political order. On the other hand, in China, the 'wealthy class' does not share political rights.

What accounts for such a new occurrence of corruption is the dictatorship of the political structure, which inevitably results in the freedom of the political powers from limitations and supervisions. Thus, Alfred Thompson Denning (1949) wrote worriedly

that we have efficient procedure to protect individuals' freedom, but we don't have efficient ways to keep powers from being abused. Denning (1979) also further elaborated on this, stating that "in order to prevent the powers from stretching, I firmly hold that previous judgment can be abandoned and the traditional views thrown away." Something has to be done to stop the administrative departments from abusing their powers. Although the conflict of government and private enterprises has become almost completely dysfunctional in China, people long for something more truthful, more insightful, more compassionate, wiser, more humble and more human. When economic activity occurs, the government also should be organized to achieve those aims (Quinton, 1967). The crucial difference between government and others is that decisions taken by governments can be enforced (Laver and Blackwell, 1983: 8).

What lessons can be learned from this case? Firstly, that governments cannot monopolise a set of functions or services. China's market economy needs liberalization but the CCP monopolizes all social resources in China. All the banks are opened and controlled by the government without any efficient supervision and in fact it is illegal in China to open a private commercial bank. If private enterprises need a loan, they have to go to the national banks to apply for a mortgage loan and bribe the officials; otherwise the banks will refuse the requirements of private enterprises with various excuses. "Socialism and the growing activities of government will usually or inevitably restrict economic freedom, and perhaps threaten political rights as well" (Olson, 1971:92). Private commercial banks which would promote economic interests above all else are prohibited entirely, and so in this case, Sun Dawu had to bribe bank officials when his Dawu Group needed a loan. It is hard to continue this process because any monopolist is likely to abuse the system. In a free market economy the economic self-interest of the individual reigns supreme and the most important factor governing all relations is profit. As Hayek (1976: 148) points out, "in these cases the objection against any monopoly powers of government must preponderate, even if such a monopoly should promise services of higher quality". Secondly, the laws are not sound. Dawu Group's actions, such as collecting money from private capital and

using nongovernmental debit and credit are supposed to be lawful acts. The local people invested in shares in Dawu Group's business to support its financing instead of providing the loan for it and this kind of investment is reasonable. Sun Dawu offered an annual interest rate of 3.3 per cent, which is a little bit higher than that of the banks. As Coase (1991) says, "If the costs of making an exchange are greater than the gains which that exchange would bring, that exchange would not take place", but the costs of exchange depend on the institutions of a country, for example, its legal system (Menard, 2000). Dawu Group's actions in relation to collecting money were difficult to manage due to vague and defective laws. As Voltaire said: "Man is free if he needs to obey no person but solely the laws" (Hayek, 1944: 61). A country of great development potential must possess a relatively complete legal system, a healthy financial system and a well-developed democratic system in a market economy. Finally, corruption, illicit rent-seeking and free riders prevent and repress the growth of private enterprises. As early as 1995, Dawu Group needed 6 million RMB to open up a grape yard of 1,000 Mu, but the president of the bank asked for 100,000 RMB in return for this. Dawu Group's application for a loan was denied when he refused the president's demand and this led to development difficulties for the enterprise. Corruption is an opportunistic behaviour, but thrives when there are defective political and economic institutions. "Because of the rent-seeking activities of other types of enterprises, state enterprises often were unable to obtain the credits and materials indicated in the plans. The rent-seeking activities also caused widespread public resentment and became a source of social instability" (Lin, Cai, and Li, 1996: 228). There are some factors which will erase the phenomenon of free riders, for example, ensuring there are more detailed rules and regulations and enforcing them to supervise group members and punishing free riders, can help solve the problem of free riders effectively. As Mises (1957) suggests, the pure market economy assumes that firstly, government is a social apparatus of compulsion and coercion, which is intent upon preserving the operation of the market system; secondly, government must abstain from hindering the market; thirdly, the government must protect the market to stop it being encroached upon by other people.

7.4. Conclusion

China started its economic reforms and open-door policy in 1978. When the 14th Congress of the Chinese Communist Party (October 1992) formally endorsed the concept of a “socialist market economy”, the Chinese economy in terms of its structure and institutional status existed almost beyond politics. Since China’s opening-up and reform, despotism of the political structure has not been eliminated. Instead, it has been further intensified. Any department and individual with power are able to rob citizens of their freedom and wealth at will. The increasing cases of corruption in the past 30 years show that the political power is malignant. The CCP is facing a crisis if it does not crack down on corruption and it will be in danger of losing its ruling position, or possibly heading for self-destruction (Hutton, 2007). Only a powerful supervising mechanism will restrain such an instinctive expansion and help defend people’s interests and safeguard the development of the economy. The government has not taken enough pains to restrain and supervise its political power. Consequently, the corruption proceeding from government is becoming more serious and frequent, hindering economic development and affecting the people of China. This shows that the reform of the political structure should start from a reinforcement of the check and balance of powers so as to clear up the despotism and privileges. “China’s insistence on economic rights before political rights is shared by developing countries in general” (Ching, 2008: 11). “Political reform is not a panacea but it does not have to be put off until China becomes a developed country. In fact, it can help China become a developed country” (Ching, 2008: 99). Adam Smith (1776) claims that a market is endowed with efficiency and self-regulation. The government should not ruin the operation of the market mechanism with its own interference. Only when individuals enjoy greater freedom of choices, will the prosperity of the society be promoted. As Fan (1994: 3) elaborates, “To survive and successfully evolve as a living social organism, the system of free markets, private property, and contractual buyer-seller transactions must operate with a legal order and in a

politically democratic environment.”

From the angle of political theory, the modern problem of government has three fundamental features: “first, a view of the governed as a population consisting largely of autonomous persons; the belief that there is a rationality of government that is independent of sectional interests and values; and third, the existence of a state in the modern sense, that is, of a distinctive institutional structure independent of the person or persons of the ruler” (Vincent, 1997: 64). The clash between public powers and private rights is unavoidable during social transformation. What China is doing now is different from when it existed in the period of the planned economy, and it is also different from that of developed countries in the West. China is now in the age of a market economy, but we have some way to go before we perfect the market economy in China. “Bureaucrats and party officials make decisions not only for medium- and large-scale SOEs, which they control directly, but also for large private companies” (Hutton, 2007: 153). The economy is doomed to suffer interference from the state. On the other hand, citizens’ consciousness of their rights has constantly been strengthened. In this case, once public powers go beyond confinement, they are surely running into the resistance of private rights. Alfred Thompson Denning (1979), the famous Lord Chancellor in Britain, said that various government departments have extensive powers over many fields, which will inevitably bring a certain amount of threats to each ordinary citizen, for all the powers may be misused or abused, which will result in the tragedy of impinging on citizens’ legal rights. The CCP knew how to innovate; as Gao (1996) says, China realized that the two reforms must go hand in hand. As Deng Xiaoping(1993) says, “the reform we are now carrying out is very daring. But if we do not carry it out, it will be hard for us to make progress. Reform is China's second revolution. It is something very important that we have to undertake even though it involves risks” (Excerpt from a talk with Susumu Nikaido, Vice-President of the Liberal Democratic Party of Japan, Deng Xiaoping, 1993: 113) but the CCP still controls all resources to maintain their power and interest group’s existing status. Without reform of the political system, economic reform cannot go

smoothly. When the government is in control of resources, it will do everything to exert its powers, and will wreak corruption and waste until all resources come to their ends and great social upheavals break out. If social disturbance is to be minimized and the changes of the government not affect social life, the government's powers must be limited and the interference of the government with the market economy be minimized. As the classic phrase of Adam Smith (1776) states, every man, so long as he does not violate the laws of justice should be left perfectly free to pursue his own interests in his own way.

CONCLUSION

This thesis applied the research methods of social science and economics to analyze the impact of present-day China's political system on the economic development in China from 1992 to 2004 and argued that the present political system of China has to be completely changed, envisaging that the system matters. It traced back the history of the CCP regime to expose the substance of the Party. It also studied the reform and opening up policies of the Communist Party since 1978 and how to assess the outcome of the reform. China's economic development was basically carried out by imitating the industrial pattern of capitalism but this potential for imitation has been exhausted, and the curse of the latecomer has thrown up many hidden risks or even

failures for China's long-term development, even though it may have generated short-term economic growth. "The Chinese economic miracle is normally attributed, first to the step-by step, pragmatic government policies which made possible rapid productivity growth, and second to massive investment, both from foreign sources (about half being overseas Chinese) and domestic savings, which are among the highest in the world." (Burgh, 2006: 60). Those government policies included abolition of price regulations, reduction of internal tariffs and multiple exchange rates, and relinquishment of the export trading monopoly. The CCP political system has seriously hampered China's economic development; monopolization has brought about low efficiency, bad service and no credit, only a plundering of the economy; dictatorship has produced a regime of violence which has filtered into every field; and there is a lack of a supervision system. "Economic progress would lead inevitably to political freedom" (Fenby, 2008: 660). The CCP single-party dictatorship has brought up many political, economic and social problems and even disasters. The only way out is to make a thorough change to the current political and economic institution. "The greatest challenge of China's economic reform is the political one; however, economic reforms in communist states usually are accompanied by some reform of the communist political system" (Lieberthal and Lampton, 1992: 59).

The international communist movement has been spurned since the former Soviet Union and Eastern European communist regimes collapsed at the end of the last century, which, in fact, was destroyed by the communist system itself because of its autocracy, one-party dictatorship and lack of political legitimacy. Thus, the Chinese Communist Party (CCP) has to be changed and it is only a matter of time once the contradictions in the Chinese economy and political institutions intensify and break out. "As long as the principle stands that the CCP leads everything, civil and political rights will not be realized" (Fenby, 2008: 667). According to the Communist Party's original intention, their ideal is social equality leading to a communist society. However, both the former Soviet Union and Eastern Europe did not make their own countries rich, strong and prosperous; instead, all these countries failed. This is the same as communist-controlled China. "Socialism is certain to prove, in the beginning

at least, the road NOT to freedom, but to dictatorship and counter-dictatorships, to civil war of the fiercest kind. Socialism achieved and maintained by democratic means seems definitely to belong to the world of utopias.”¹⁵⁴

China now has become a nation with the most serious economic inequalities in the world¹⁵⁵ even though the GDP of China is increasing each year. Facing a crisis of survival, the CCP was forced to reform China’s economy in the 1980s but it is still hard to prevent them from following in the footsteps of the former Soviet Union and Eastern European communist regimes. China faces serious, growing internal problems which include corruption, severe inequalities of income, unemployment, mounting unrest, increasing organized crime, severe environmental pollution, and water shortages. China has to reduce the everyday role of the party and the weak points of dictatorship in order to foster economic growth (Menges, 2005). In the face of all these problems, how has China managed to grow so fast? “The World Bank provides the answers. It estimates that between 1990 and 1998 China’s high of investment added 6.4 per cent the annual growth rate; migration of workers from rural areas has added around 2.1 per cent. The increase in the labour force brought the growth rate up to 9 per cent. The proportional contributions to growth were very similar in the 1980s. As the World Bank remarks dryly, China is gaining relatively little benefit from

¹⁵⁴ Chamberlain, W. H., *A False Utopia*, 1937, p.202-203 (21). Mr. W.H. Chamberlain, who in twelve years in Russia as an American correspondent had seen all his ideals shattered, summed up the conclusions of his studies there and in Germany and Italy in this statement above (Chamberlain, W. H., *Collectivism, a False Utopia*, New York: Macmillan, 1937).

¹⁵⁵ The economy has become far too reliant on exports and fixed investment. Depending on the metric chosen, these two sectors now account for between 70% and 80% of overall Chinese GDP. And they are still expanding collectively at around a 25% annual rate (Roach, 2006). At present, China’s energy consumption of GDP is 3 to 11 times as much as that of the developed countries. Such a crude mode of economic growth has been going on. For more than 50 years since the CCP came to power in China, its GDP has increased more than 10 times while its consumption of mineral resources has increased more than 40 times. In 2004, China’s energy consumption per unit was 2.4 times higher than the world average. To be more exact, it is 4.97 times higher than that of Germany, 4.43 times higher than that of Japan and 1.65 times higher than that of India (Outlook News Weekly, February 2005; See also Chapter 6.3).

technological progress by its urban enterprises. They add a mere 0.5 per cent to the growth rate – almost nothing” (Hutton, 2007: 159). The reasons for their ultimate failure are due to: a). the CCP regime’s own characteristics, such as violence, dictatorship, autocracy, information blockades, and repressing democracy, freedoms of speech and press and the suppression of human rights; b). the CCP’s reform is not showing a complete change in both political and economic institutions but only demonstrating small patchy changes instead; c). these patchy measures have reached a summit because the reform of the political and economic systems are not in step and the political system has seriously blocked China’s economic development. The system of one party dictatorship and autocracy such as bureaucracy, over-concentration of power, patriarchal methods, an absence of supervision, life tenure in leading posts, offering or accepting bribes, vested interests, corruption and privileges of various kinds have restricted and bound the development of the Chinese economy. It is impossible to allow the development of a market economy because a free economy needs a loose and enlightened political, economic and social environment. The Communist Party members can continue to hold power, not because they are so-called “pioneers”, but because they suppress people with police force, and so drive the people to revolt (Chang, 2002: 156). “Marxism has led to Fascism and National Socialism, because, in all essentials, it is Fascism and National Socialism.”¹⁵⁶ We must look at and review the contemporary political status and history of the CCP first to probe into this issue.

When we look back at the history of the CCP it is easy to see that the political system

¹⁵⁶ F.A. Voigt, *Unto Caesar* 1939, p. 95 (21). Mr. F. A. Voigt, a British writer, concludes this after many years of close observation of developments in Europe as a foreign correspondent. Also see *The End of Economic Man* 1939, 230. (21). A German writer, Mr. Peter Drucker writes that “The complete collapse of the belief in the attainability of freedom and equality through Marxism has forced Russia to travel the same road towards a totalitarian, purely negative, non-economic society of unfreedom and inequality which Germany has been following. Not that communism and fascism are essentially the same. Fascism is the stage reached after communism has proved an illusion, and it has proved as much an illusion in Stalinist Russia as in per-Hitler Germany” (the quotation from Hayek, 1944: 21)

has played a decisive role in China since the CCP was founded on July 1, 1921 up to now, from the CCP as a Separatist Warlord fighting for power with KTM during 28 years of cruel struggle to the purge of a political party. After the establishment of the CCP, the Party founded the People's Republic of China and the whole country went through a series of political movements. The CCP mainly concentrated on pursuing political and ideological leadership over the Chinese people. This series of movements brought about enormous losses for the nation. These problems were not Mao Zedong's errors but the errors of the whole of the CCP and its political system. The Communist Manifesto states that, "The history of all hitherto existing society is the history of class struggle." This represents the Communist Party's concept of history and the world. As Deng Xiaoping says (1993:212): "Mistakes are not only made by Mao Zedong but many competent comrades. The centre's error is not one person's responsibility, but the whole collective. It is our political system's problem." "The CCP Central Committee in June 1981 also acknowledged that the Central Committee had been partly responsible for the breakdown of collective leadership" (Fairbank, 1992: 408).

From 1978 to now, the formation of economic policies have gone through three clear stages:

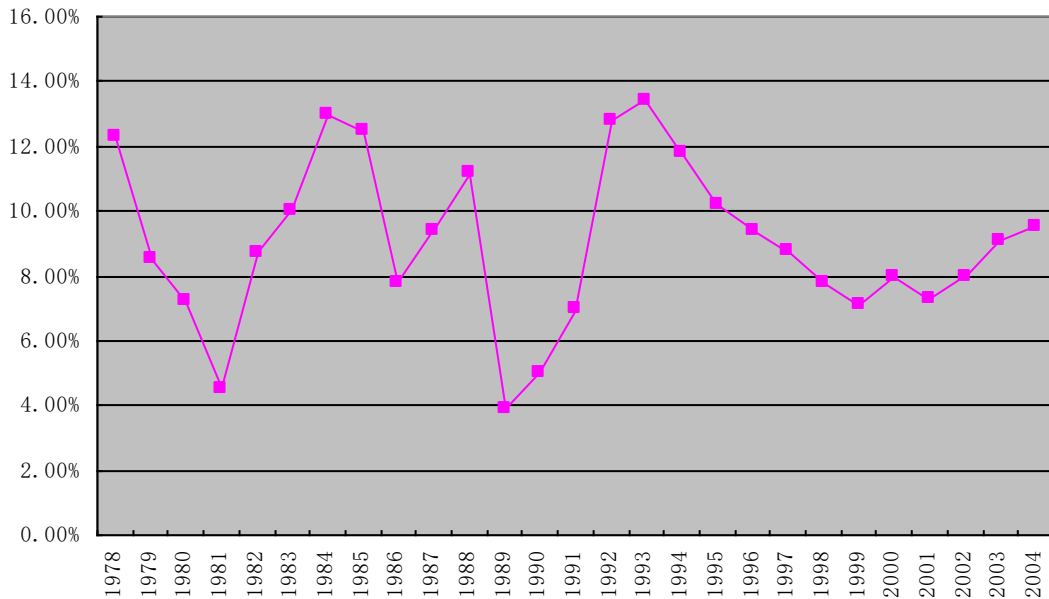
Phase 1: "taking the planned economy as the mainstay and market regulation as a supplement" (the Third Plenum of the 12th Central Committee of the CCP in 1984) →

Phase 2: "the creation of a planned commodity economy" (The 13th Party National Congress was held in Beijing of October 1987) →

Phase 3: "to establish a socialist market economic structure" (The speech given by Deng Xiaoping during his inspection tour of the south in 1992). In the meantime, we can see the three stages of change in political reform such as changes in economic policies. From the beginning to the end, the CCP very clearly stressed three issues: (a). the four cardinal principles (Deng Xiaoping's speech on the Party's theoretical work in March 1979); (b). the one centre and two basic points (The 13th Party National Congress in 1987); (c). the main

tasks of political restructuring for the present and a period of time to come are to develop democracy, strengthen the legal system, separate government functions from enterprise management, streamline government organs, improve the democratic supervision system, and maintain stability and unity (the 15th National Congress of the CPP in 1997). And the political system should pursue its path of improvement without following the pattern of western political system (the 16th National Congress of the CPP in 2002). It can see that the CCP will under no circumstances lose its power and will keep the CCP's leadership and dictatorship of the proletariat forever. What is it that should remain unchanged? The Chinese newspaper, the People's Daily, explains thus: "The Party's basic line of 'one centre, two basic points' must last solidly for one hundred years without any vacillation" (Xinhua News Agency on March 4, 2004). In fact, the sole objective of the CCP's reform of its economy is to maintain the CCP's ruling. Therefore the economy reform is not radical action because of interference from the political system. Undoubtedly, this political system is not efficient so it is impossible for further action to be implemented. "Efficient economic organization is the key to growth; the development of an efficient economic organization in Western Europe accounts for the rise of the west" (North, 1973:1) .This is shown by figure Con1. below:

Figure Con.1.The Statistical Figures of the Growth Rate of GNP, 1978—2004.



Sources: *China Statistical Yearbook (from 1978 to 2004)*, State Statistical Bureau of the People's Republic of China.

The most interesting phenomenon illustrated by figure Con.1. shows that the three highest points of the Growth of Rate of GNP belong to the three stages when the CCP decided to made economy reform:

12.3 per cent in 1978 --- The household contract responsibility system

13.0 per cent in 1984 --- The planned economy as the mainstay and market regulation as a supplement

13.4 per cent in 1993 --- To establish a socialist market economic structure

But there is not an efficient organization, namely a political system, which can establish institutional arrangements which will create incentives to channel the growth of the social economy. In other words, if the present political system of China is not completely changed, China cannot move forward. Its political and economic development has reached a pinnacle and although today's China appears prosperous, social conflicts have built up to a level never seen before. People must object to monopoly powers of government without compromise, even if such a monopoly

should promise services of higher quality.

Good institutions can get good result. The game between political power and economic power can lead to an imbalance of interests and benefits, and this imbalance is the result of the lack of reform to the political system, as well as the slow process of the evolution of economic system mixed with stagnation, conflict and imbalance of development. “Economic growth has been very uneven and it has produced wide discrepancies of wealth, both individually and regionally. It has also brought with it corruption and other social evils which in its early years as the government of China declared it had abolished” (Roberts, 2003: 466). The development of human societies is based on the profound political, economic, social, historical and cultural conditions, and is based on the systematic tendency of property rights, the state, and institutions and institutional change as well as path dependence. Only if there is a clear understanding of the cost and benefits of institutional change, particularly the important effect of the political system on the economic institutions, can a way out for institutional reform be found, which can also serve as guidance to the reform of the political and economic institution in the future. But the CCP is never planning to accelerate political reform.¹⁵⁷

Corrupt institutions that prevent or repress further economic growth are the common fault of present-day China. These institutions are so common that they add greatly to the cost of the exchange of economic activities. And the lower the costs of exchange (transaction costs if you will), the more specialization there will be and the greater the productivity of the system. But the costs of exchange depend on the institutions of a country: its legal system, its political system, its social system, its educational system, its culture and so on. “There will be most important in the process of political liberalization in China: the hundreds of millions of Chinese citizens who want fair,

¹⁵⁷ Walden claims (2008: 193): “Chinese leaders suggest that political reform will come, eventually. ... China will become stronger and therefore fitter to take the strains of a transfer to a more democratic regime. But now how long are the timescales in question.”

legal and effective government. They want their system to work properly and they are becoming increasingly dissatisfied because of serious problems of daily life they see as caused by the party” (Menges, 2005: 486). Institutional problems stand in the way of further rapid growth in the future of China. The model of the state utility-maximizing is on the basis of good services, personal and human rights protection, maintaining social justice and reducing the cost of exchange, and the protection of property rights for each person. But the CCP only engages in economic reform without political reform. The false appearance of an economy that flourishes in the short-term has hindered the natural “evolution of social systems”. The corruption and profiteering of government officials has also heightened the debate surrounding the political system. Authoritarian reformers now saw a greater need for administrative reforms in the sense of establishing a professional civil service system, and separating the functions of the Party organs from governmental organs. The democratic reformers advocated a more fundamental reform of the political system, with some even going so far as to demand a Western form of democracy based on a multiparty system, complete with freedom of the press. It is this incomplete reform that has caused an increasing imbalance in Chinese society and sharpened social conflicts. The CCP is in effect a party of groups with special interests. It does not wish to damage its groups’ interests itself so instead it persists in activities which harm economic growth, full employment, coherent government, equal opportunity, and social mobility. The CCP understands that if it fails to change the political system, it will be unable to preserve its economic gains it has made through its economic reforms and build on them, causing the growth to be stunted. If the CCP does not institute a reform of the political structure, it will be difficult to carry out Chinese economic reform, but every reform measure will involve a wide range of people, and it affects the interests of countless individuals.¹⁵⁸

¹⁵⁸ From a talk with Yoshikatsu Takeiri, Chairman of the Central Executive Committee of the Komei Party of Japan, on September 3, 1986 (Deng, 1993).

Competitive markets are efficient and a perfectly competitive market means therefore that it is perfectly efficient, and competition encourages efficiency (Olson, 1982) but present-day China lacks a perfect competitive market. China's political and economic reforms will change China from its backward autarky economy to a market economy as it carries out institutional changes. China, in the meantime, is governed by a unique communist system so China's political and economic reforms are actually changes from a dictatorship to democracy and freedom. But "democracy is an essentially individualist institution stood in an irreconcilable conflict with socialism. Democracy attaches all possible value to each man; socialism makes each man a mere agent, a mere number."¹⁵⁹ "For communist political systems there is a special problem because they come to power under a cloud of suspicion regarding their legitimacy....Communist rule by force, occasional purges, sporadic periods of terror have not lessened efforts of these leaders to win voluntary citizen support for their political legitimacy" (Gripp, 1993: 40-41). In essence, the political system reform is in irreconcilable conflict with the CCP's dictatorship. Once such a conflict is beyond the CCP's tolerance and harmful to its interests, the CCP will try every means to maintain its benefits and interests, as was seen in the Tian anmen Massacre in 1989. The classes with vested interests tried to maintain their existing institutions and block further political and economic reforms. In addition, the CCP's "purposes of political reform are just to bring the initiative of the masses into play, to increase efficiency and to overcome bureaucracy."¹⁶⁰

Property rights constitute the institutional framework. The inefficiency of the property rights structure inevitably results in the inefficiency of the institutional structure. In the absence of property rights incentive, the most important fact that determines the growth of innovation and technological change is the size of the market (Sokoloff,

¹⁵⁹ Discours prononcé à l'assemblée constituante le 12 Septembre 1848 sur la question du droit au travail; Euvers complètes d' Alexis de Tocqueville, voi. IX, 1866, p.546 (quoted from Hayek, 1944:18)

¹⁶⁰ Remarks made on 12th, September 1986 after hearing a report from the Central Committee's Leading Group for Financial and Economic Affairs(Deng, 1993: 25).

1988). Many people in China cannot understand property rights and the effect of property rights, and it is not easy to implement the law of property rights in the absence of both economic democracy and political democracy because many Chinese people who live according to autarchy rule ignore social justice in their quest for property rights (Fewsmith, 2001). The institutional innovation is the innovation of the structure of property rights. The existence of a State is essential for economic growth. The government serves as an agent of the state organs. Political reform for the sake of accelerating the growth of democracy and promoting social progress and political reform can achieve social justice, economic democracy and also protect individual property rights (Fewsmith, 2001). The government specifies and enforces property rights on behalf of the State and therefore it has to be responsible for economic growth or decline. It plays a vital role in economic reforms and institutional changes. China is short of a clear system of property rights, with the party-state claiming particular privileges, making debt enforcement against state organizations close to impossible (Hutton, 2007).

If China wishes to create an economic miracle and continue its economic development, the CCP must abandon the “party’s basic line” and carry through not only economic reform with real free-market principles, the principles of spontaneous market order that James M. Buchanan (1979:81-82) has called “the principle of spontaneous order”, the “most important central principle in economics”, and the rule of law, but also political reform with “constitution of liberty”, private property, freedom of contract, and limited government because economic and political reform are inseparable. As Menges (2005: 486) says, “there are hundreds of millions of Chinese citizens who want the government to follow its own constitution and laws and who object to arbitrary illegal taxes, bribes, demands, and threats from a wide variety of local, provincial, and national officials of the regime and the party.” “If China is to preserve and expand upon its recent achievements it will need a constitution that institutionalizes, and not simply tolerates, the forces that have led to improvements there” (Pilon, 1998: 333). It is time for the Communist Party to

abandon its top-down model of “stability” and allow the forces of freedom and individual responsibility to create a new constitutional order from the bottom up—based on the consent of the people and a respect for their natural rights to life, liberty, and property (Dorn, 1998).

Political systems favour stability and balance. Systems are self-regulating mechanisms which seek to perpetuate their own existence and the political system is no exception (Heywood, 2004). Political systems and the economy are inextricably interlinked when thinking about economic performance. The game between the political power and the economic power causes society to lose balance and conflict thrive. As different institutional changes have different political, financial, social, historical and cultural sources as well as strong path dependence inclination, only when it understands the present political system change of China, can the country find a path of sustainable development in its economy. Between 1978 and 1992, China’s economy underwent an unprecedented transition from a centrally planned economy to an economy driven primarily by market forces operating within a context of increasing privatization. Furthermore, this transition occurred with China maintaining a sustained high growth rate. China’s gradual transition was initiated by the existing planning regime and boosted by the state’s leading role in allocating resources, providing incentives, facilitating information flow, and orchestrating institutional reforms. With no significant nominal regime change, China’s transition sustained rapid economic growth but this was accompanied by many problems, for example, corruption: “The annual economic loss between 1999 and 2001 due to corruption averaged 14.5 to 14.9 per cent of GDP....Every incident of corruption - smuggling, embezzlement, theft, swindling, bribery – arises in the first place from unchallengeable power of communist officials and the lack of any reliable, independent system of accountability and scrutiny ”(Hutton, 2007: 129).¹⁶¹ By drawing heavily on China’s unique history

¹⁶¹ As Gittings (2005: 327) argues, “China has to move forward if not to a pluralistic democracy then to a greatly modified system in which the ‘ruling party’ seeks its mandate from the public and submits to genuine scrutiny of its behaviour and performance, especially over the crucial issue of corruption.”

and social institutions, some of these innovations managed to address effectively the dilemmas between the political system and the economic system. An increasing number of economic and institutional reforms that are also democratic and liberal have to be introduced into China; they will probably pave the way for a regime change that will eventually determine China's future.

“In China, the weakest and most worrying area, which imposes a necessary caveat on any confident prediction, is the inability of the political superstructure to evolve in pace with the nation's rapid economic and social transformation” (Gittings, 2005: 327). The problem with reform in China runs deeper. The fact that it is likely to be lacking amongst the power hungry and frequently corrupt party leaders is just one problem. In the short- or medium-term the CCP would find it next to impossible to democratize in any serious way even if it wanted to. “To run the country, the government and the CCP have established roughly parallel national bureaucracies extending from Beijing down to local levels” (Mirsky, 2008: 121). A history of organization and personnel has been embedded in virtually all CCP and government bodies. Even on the government side, all officials in these personnel departments are members of the CCP, and they follow rules and regulations by particular bodies of which they are formally a part. This system has been used to assure higher-level CCP control over the appointments to all positions in the CCP, government and other major organizations.

China's economic reforms were implemented in the absence of constitutional transition by the Chinese communist party regime. During this period, economic reforms consisted of three major pillars: price and trade liberalization, stabilization, and privatization. From the very beginning, all of these measures remained incomplete, and indeed some of them failed during this period. The present Chinese government often lacked the political and constitutional means to implement reforms,

and also the government lacked constitutional restraints on its own behaviour, so that many opportunities for reform were destroyed by official abuse and corruption. “The CCP has repeatedly described itself as a ‘people-centred government’. But China still lacks proper legislation to protect personal rights and information” (Ching, 2008: 97). There is growing statistical proof that democracy and economic advantages are closely associated. But China could also share democracy with rival political parties, free speech, free press, and free assembly. This is ideal, but China would probably not achieve it by the year 2100 (Salisbury, 1992). Democratic institutions may be rudimentary and incomplete, but over a period of decades democracies tend to manage their resources more effectively and accommodate themselves better to necessary economic and social changes. “As for China, the next phase of its growth will probably be accompanied by more pluralism.....democratic systems make fewer such mistakes than others...Pluralism thus improves the quality deliberative decision-making; as a process it also provides crucial safeguards for the whole system by offering insurance against mistakes”(Hutton, 2007: 192-93).

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