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# China Facing Growing Problems

Following the death of Deng Xiaoping, the economy of the People's Republic of China appears to be healthy. The Office of Statistics in Beijing estimates GDP growth for 1996 at nearly 10%. The industrial sector expanded by 13% with a marked production shift from mass consumer goods to higher-tech goods in line with observed changes in demand trends. The rate of inflation was rolled back from 14.7% in 1995 to about 6% in 1996 and China's foreign trade figures have improved: the trade balance recorded a plus of \$ 15 billion with foreign investment likely to reach about \$ 40 billion and according to information in February 1997 the Chinese central bank is now handling record foreign exchange reserves of \$ 105 billion.

Even though scepticism regarding the exactness of the statistical data may be justified, there is no doubt that the Chinese economy is in the midst of a dynamic upswing. With its impressive growth rates China is well on the way to outperforming today's leading economies. The picture is different, however, with regard to per capita value added and there continue to be large disparities in prosperity.

The successes recorded in China for 1996 are the last link so far in a chain of development forged by Deng Xiaoping in 1978 with his pragmatic economic reforms. They were the response to Mao's egalitarianism and the devastating economic outcome of the radical Cultural Revolution from 1966 to 1976. The de facto reprivatization of farmland and the establishment of agricultural markets, the open-door policy and the inclusion of industry in the reforms in 1984 laid the foundations for success.

Deng combined his 1992 "tour of inspection" of the economically successful special economic zones in the southeast with an unmistakable appeal to China's Communist Party and to the Chinese government to press on with the policy of opening up the economy instead of putting off reforms. Deng sensed - and the current leadership has also grasped this - that the reforms are irreversible because the broad masses of the Chinese people associate the increase in their prosperity with these reforms even though this increase has in part been only modest.

Looking at this record of success one might think that the leadership cadre Deng put in place years ago, President and Party Secretary Jiang Zemin, Premier of the State Council Li Peng and Chairman of the National People's Congress Qiao Shi, will not have to worry too much about the economic and social future of their huge country, now that he is dead. This assessment proves in fact to be quite superficial, however, since Deng has bequeathed to his successors in office some fundamental problems not only in the political sphere but also in the economy. In his own pragmatic way, Deng disregarded the fact that the prosperity resulting from his reforms was inequitably distributed among regions and among different sections of the population. The political leadership, however, vowed that all Chinese and non-Chinese in every province of the country were to share in the new-found prosperity in the foreseeable future and that a new polarisation between rich and poor would not be tolerated by the Communist Party of China.

But the opposite is in fact the case. A small social stratum of nouveau-riches at one end of the spectrum contrasts with nearly 70 million farmers living below the poverty line and

over 100 million itinerant workers at the other. The number of poor will continue to rise as many companies make necessary adjustments, and household income in the towns is already declining. And the wealthier provinces are not prepared to help the poorer ones - on the contrary!

An even graver associated problem is the technically obsolescent and poorly managed government industry sector, particularly in North China. Deng did not really grapple with this problem even at the height of his power. One reason for this may have been that a major component of government-run industry is made up of heavy industry and mechanical engineering, the output of which he saw as essential for national development as a whole and for the Chinese-style market economy. Also because this sector employs more than 200 million people, he was at no time prepared to take responsibility for the laying off of the workforce for economic reasons, especially as there was no functioning modern welfare net in place.

Amidst an economy thriving in many areas, the problem of the labour-intensive, technologically obsolescent and loss-making government-run enterprises has become increasingly apparent in recent years. For fear of dramatic social and possibly political repercussions, until now neither the President nor the Communist Party nor the Li Peng government have dared to really take this problem on. The attempt to separate management and ownership through the so-called contract system has not adequately succeeded in unleashing the hoped-for in-company initiative. The state sector has simply missed the market economy train. The reform adopted in 1993 has been shelved.

Following Deng's death and with the impending take-over of Hong Kong on 1 July 1997 as well as the People's Congress due to convene in autumn, too much is at stake for the current rulers to do anything about the government-run enterprises that might result in unpredictable social disruption. The new leadership team manifests political and economic stability but reform is being deferred although the party and state leadership knows perfectly well that this problem could turn out to be a ticking time-bomb. Instead of taking action themselves, they are sitting tight until the National People's Congress takes its decisions in autumn.

Nearly half of all government-run enterprises make losses - and these have been increasing for years; a further good 20% at least do not make a profit. Only 30 out of 100 state enterprises in industry, then, are competitive. The survival of the majority of these companies depends on direct government subsidies and on the economically irresponsible lending policy of the banks which has been expressly approved by the Central Committee. This policy also hinders the development of the banking system because it impedes the ongoing process of commercialisation and hence the emergence of self-regulation in lending. Banks have been entrusted with the task of helping to avert mass unemployment via a generous lending policy. Where banks have already lent large sums to ailing government enterprises, they are even keener to save these enterprises from bankruptcy. There is widespread fear of a domino effect.

Despite the precarious economic plight of many firms, Li Peng insisted more than a year ago that they should not be forced into liquidation since this was an unscrupulous capitalist practice that would cause unjust harm to the working people. The problem of redundancies is not, however, confined to the loss-making state enterprises: companies still making profits have a tradition of employing too many people.

The solving of these and other problems will decide whether the very high growth by international standards can keep up its momentum to the threshold of the next millennium. In the longer term the lack of opportunities for the impoverished masses and the backward provinces will be a major impediment to future development. To progress further, China needs economic and political stability. Inner stability will depend on what new path the future political leadership decides to take.

*Klaus Bolz*