



## Briefing Note

# Thirty Years On – China Celebrates the Reform Process

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## Summary

- December 2008 marks the thirtieth anniversary of China's official Opening Up and Reform Process. There will be a number of meetings and events from this month till the end of the year in China reflecting, assessing, and celebrating China's achievements since 1978.
- The Beijing leadership will be looking at the good, and the bad. China's status as the world's third largest economy, the largest holder of foreign reserves, the second largest exporter of manufactured goods, are clear benefits of the reform process. But the costs on the environment, growing energy demands, and the social issues are all problematic – and worsening.
- With the global credit crisis deepening, China stands in an ambiguous position. The recent Olympic Games improved its image. People in the rest of the world are aware as never before of China's global importance. Given current financial instability, China's state funds increasingly appear a lifeline for beleaguered Western companies.
- And yet the Chinese leadership look cautious. Will the following months see them emboldened? How much more do we know about China's vision of what it wants to become? Will the rest of the world welcome more proactive moves by China? Or will the same political reservations and fears remain, even when it is clear that the state of the global economy can only be improved through collective effort, to which China is key?

## Introduction

In late December 1978, over two years after Mao's death, the third plenum of the 11<sup>th</sup> Party Congress of the Communist Party met in Beijing. Hua Guofeng was nominally Chair of the Party and President of the Country. But his Vice Premier Deng Xiaoping was the man everyone was watching. During a speech at that meeting, Deng deployed the term 'seeking truth from facts', and returned to the original commitment of the Chinese government (in the 1950s and early 1960s) to 'support the Four Modernisations' of 'agriculture, industry, technology and defence.' There was explicit admission that the Maoist economic model (heavy central state control) had failed and that China needed to find a new way forward. Thus began the Opening Up and Reform period, in which China liberalised its economy, opened up to foreign investment, and sought to create greater knowledge sharing partnerships with the rest of the world.

Thirty years on, most of the protagonists of that era have died. Deng passed away a decade ago. He had gone on, at the age of 76, to become the paramount leader of China, and what is now called the 'core of the leaders of the second generation of the People's Republic of China.' Huo Guofeng effectively retired from political life in the early 1980s, but he died, ironically during this year's Olympics. He was the same age as the Communist Party of China – 87.

Throughout the last 30 years, China has, as a result of the decisions made in 1978, created a remarkable, unique economic model, and in some areas has been extremely successful. Up to 400 million people, on the World Bank's reckoning, have been lifted from poverty. After the Household Responsibility System was implemented in 1984, farmers were able to sell agricultural surpluses back to the state for a profit. This radically improved the efficiency of the agricultural sector, freeing up people to work in Town and Village Enterprises, which have been, and remain, one of the key drivers of the non-state sector in the Chinese economy. Deng was to admit that this had been 'unplanned', but it was extremely successful. In 1981 he allowed the setting up of the first of the Special Economic Zones. Shenzhen now ranks as one of the most prosperous and dynamic cities in Asia. Shanghai joined it in 1990. Despite the student demonstrations in 1989, China went on to deepen and further its reforms in the 1990s, overseeing a massive influx of foreign direct investment from 1992. In the last three years, it has become an increasingly significant investor abroad. It now has, through the Chinese Investment

Corporation and the State Administration for Foreign Exchange (SAFE) stakes in over 100 listed companies in London, New York and Hong Kong.

The Central leadership in Beijing (which has now moved through the third generation around Jiang Zemin, into the fourth, around Hu Jintao) are holding meetings from October this year, into 2009, reflecting on what the Reform process, as it has come to be called, has meant, where it has succeeded, and where China now has to go. There have been critics aplenty over the last three decades, from those who thought that economic reform needed to go deeper into political reform, to those who felt that China had conceded too much and had lost the true spirit of the revolution upon which the PRC was founded in 1949. During the 17<sup>th</sup> Party Congress last year Hu Jintao, in his keynote speech, answered these questions by simply saying that the reform and opening up process was correct, and that it would continue.

Even so it is unlikely this leadership will be sitting on their laurels when they meet this month and next. Their initial discussions will centre round an honest assessment of the Olympics. 44 billion dollars shorter they might be, but on the whole, they will feel that the exposure the event gave (four billion alone watched the Opening Ceremony) was worth the expenditure. What will worry them more is the painful, grinding and highly confrontational build up to the games. Unrest in Tibet, along with a very rough reception given to the Olympic flame as it proceeded through European and North American cities, problems about China's role in Africa (particular Darfur) and finally fallout from the tragic earthquake in Sichuan in May all brought the leadership close to calling the whole event off. They will wonder what it is about China and its current prominence that raises this sort of negative reaction in some parts of the world. And they will ask questions about how they communicate with the rest of the world. Pointedly, only Hu Jintao said a few words during the Opening Ceremony of the games. The rest of the leadership kept low profiles, Xi Jinping, the current favourite to replace Hu as Party Secretary and President in 2012 was almost invisible, despite his nominal role as spokesperson for the whole event. Perhaps they have reason to blame luck rather than design for such a successful Olympics. The stellar performances by sports people offered the ultimate distraction. What would have happened if lacklustre sport had been accompanied by more aggressive public protests? The leadership will be thinking through these scenarios and wondering how they now need to communicate with the world, after having secured their attention.

In their assessment of the last 30 years, they will also factor in the clear problems that the liberalisation has brought with it. China's environmental problems remain grave. Its hunger for energy continues apace, taking it into involvement in parts of the world which are high risk and unstable. After two decades as an exporter of deflation, supplying the world with cheaply made goods, it now sees the impact of abolishing government controls on the costs of land, capital, labour and utilities in China impact on manufacturing costs and mean that it is not quite as competitive as it was a few years back.

The global economic crisis is now impacting on China. One unexpected area is that the USD2 trillion foreign reserves China has accrued in the central bank, and is partially looking to invest abroad, look like the safest source of capital in a world teetering on the edge of an abyss. In late September this year, the head of the Chinese Investment Corporation, set up in September last year to start making overseas investments with state funds, was in California. There were rumours that he was looking to talk to Morgan Stanley, a bank the Chinese already have a 9% share in, about increasing this to almost 50%. The possibility of China owning so much of a symbol of US capitalism, and the interpretation of this as a sign that power was shifting from the US was not lost on many. In the end, the Chinese did not move – possibly through fears of a political backlash. But in such needy times, there is increasing speculation about when the west might well need such help, and when the day might come when it can no longer say no.

China has changed almost beyond recognition since 1978. Since it joined the WTO in 2001, it has become an integral part of the global economy. More open than Japan's economy, larger than India's, it continues to cast a shadow over the rest of the world. But this leadership knows that there is work to do on communicating what China now wants and where it plans to go. The economic success of the last decades would not have been possible, as Deng Xiaoping made clear in the 1980s, without a benign, peaceful and stable international environment. Conflict with partners like the EU, the US or even Russia, is not in China's interests. But it knows that it has reached the size, and the international situation has reached the point, where its every move is watched, interpreted, and could be a trigger for fear, protectionism and even conflict. Thirty years on, China's leaders, and its people, can allow themselves a few moments for congratulation. But almost immediately they will start thinking about the next steps – to continue and deepen reform. And these will perhaps be the hardest steps China takes in its progress towards being a major international power in the 21<sup>st</sup> century.