

China's New Political Economy

Susumu Yabuki and Stephen M. Harner

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In this thoroughly revised edition of Susumu Yabuki's 1995 book, Stephen Harner (translator of the 1995 book) joins Yabuki to paint a broad picture of China's evolving political economy. A rich array of information is presented in a clear and imaginative way, covering all the key facets of the transition from plan to market. This is a book no China watcher will want to be without.

As a leading Japanese sinologist, Yabuki provides an interesting perspective on the many changes that have taken place in China's economic, political, and social landscape since the days of Mao Zedong. Likewise, Harner, a former diplomat and chief representative of Deutsche Bank

AG in Shanghai, draws on a wealth of experience to provide an informed analysis of China's budding financial markets and the state of fiscal and monetary policy.

The book is divided into four parts with 31 chapters. Yabuki is the sole author of part 1 (chaps. 1–5), which deals with the makeup of the People's Republic of China (PRC), population trends, the history of Chinese socialism, the role of the Chinese Communist Party (CCP), and the status of the economic reform movement. He is also responsible for part 2 (chaps. 6–17), which covers a number of important domestic issues, including China's growth path, food production, energy and the environment, income distribution, consumer spending, industrial structure and state-owned enterprises (SOEs), unemployment, township and village enterprises (TVEs), and regional development.

Part 3 (chaps. 18–25) is primarily written by Harner: he is the sole author of each chapter in this part except chapter 25, which he coauthored with Yabuki. Harner's chapters cover government budgetary matters, tax policy, the role of the People's Bank of China, banking reform, equity and debt markets, the treatment of foreign financial institutions, China's investment allocation system, and the future of Shanghai as a financial center. Their joint chapter deals with the problem of administrative reform.

In the final section (chaps. 26–31), Harner contributes two chapters: one on the 1997–98 Asian financial crisis (chap. 28) and another on U.S.-China relations (chap. 30). The remaining four chapters, by Yabuki, examine foreign trade, China's accession to the World Trade Organization (WTO), the role of foreign-invested enterprises (FIEs) in fueling economic growth, and the future of China's relations with Hong Kong, Taiwan, and Japan.

Two appendices add value to the book: Appendix A provides a chronology of important events that took place over the 1978–98 period as China opened to the outside world and reformed its political economy; Appendix B gives key indicators of the trend of China's economy over the 1978–97 period. Although both appendices need to be updated, they will prove useful for anyone who wants a quick introduction to China's new political economy.

The authors leave no doubt about the direction they think the Middle Kingdom is heading: "Economic reforms will be pursued more steadfastly and effectively than ever in the past," and "the result will be China's continuing rapid advance to higher levels of prosperity, international importance, and national strength" (p. xxv). The primary purpose of their book is to illustrate China's journey from central planning to a market-driven economy and, in the process, paint a realistic picture of China's place in the global economy. With that goal in mind, they begin by examining six commonly held views of China and explain why conventional wisdom is often wrong.

First, China is not like the former Soviet Union and is not about to

break up, nor does China present a similar strategic threat. China is an emerging great power, to be sure, but how that power is used will depend in large part on the pace of liberalization, especially on China's accession to the WTO.

Second, China is not about to encounter a "food crisis." Agricultural reforms are occurring, market prices are more widespread, and trade barriers are being lowered. Unless the government makes a major policy mistake, the authors believe there is no need to fear either a food "crisis" or a food "threat."

Third, China does face a problem in ensuring new energy supplies as the economy grows, and there are environmental problems. Solutions to those problems, however, are essentially market based. Establishing private property rights and letting prices and profits guide energy production and consumption are the only proven steps to prevent an energy crisis. And, as the authors point out, "only through economic development will the material conditions to deal with environmental problems be created" (p. 3). The lack of well-defined private property rights in China and the absence of a free political system are the real issues that must be resolved in order to prevent future energy and environmental crises in the PRC.

Fourth, the Chinese economy does suffer from misdirected investment, but it is not a "bubble economy" in the sense that Japan's was. The authors point to China's high savings rate and to its continued strong growth as positive signs that the problems of nonperforming loans and overinvestment can be resolved without a major blow to long-run prosperity. They recognize, however, that "the system of market socialism is fundamentally flawed" and that reform must continue if the institutional incompatibilities in the present system are to be resolved.

Fifth, China's potential market is large, but its actual domestic market is quite limited. Foreign investors entering China soon realize that local competition can be tough and that there are many barriers to expanding market share. With China's accession to the WTO almost certain, market access should improve in the future.

Sixth, China's sovereign risk, in terms of defaulting on its foreign debt, is low. However, China poses a significant risk for private investors because of the lack of a transparent legal system that protects property rights. That risk will be reduced as China adopts international standards and opens domestic distribution channels to foreign investors as part of the WTO protocol.

In sum, an objective and realistic view of the Middle Kingdom at the beginning of the 21st century is that it "is not a specter threatening the West; neither is it the El Dorado for world business" (p. 6).

The comparative advantage this book has is its presentation of a vast amount of data in a concise manner to illustrate the heart and soul of China's new political economy. The book constantly links the economic data with the political events surrounding China's liberalization. Organi-

zational charts provide an excellent understanding of the complexity of China's political decisionmaking process and show how the administrative structure of government is slowly changing as the nonstate sector of the economy expands.

In chapter 5, Yabuki nicely outlines the key elements of the CCP's 50-point program (the "Fifty Articles") for "the Establishment of a Socialist Market Economic System," adapted in November 1993. He breaks the program down into five areas: (1) enterprise reform, (2) financial reform, (3) investment system reform, (4) tax and budget reform, and (5) foreign trade reform. He then summarizes the status of each set of reforms in Table 5.1 (p. 45).

Unfortunately, his survey ends with 1997. Thus, although he notes that the 15th Party Congress adopted the "mixed economic" model in September 1997, he does not report that the PRC Constitution now recognizes that "individual, private and other non-public economies . . . are major components of the socialist market economy" and that "the state protects the lawful rights and interests of individual and private economies" (Article 11, as amended March 15, 1999). The rapid pace of reform since 1997 and the reforms expected after China joins the WTO mean that the next edition of this book will have a ready market.

It is a well-known fact that China's real gross domestic product has more than quadrupled since 1980, and that millions of people have escaped poverty. A large part of China's rapid economic growth can be attributed to the institutional changes that have allowed the emergence and growth of the nonstate sector, which now accounts for nearly 70 percent of the value of industrial output. In chapter 11, Yabuki finds "a clear tendency toward higher GDP growth rates as the proportion of non-state-owned enterprise increases" (p. 100). FIEs and TVEs have played a particularly important role in generating growth in the coastal regions.

The question of ownership, however, is complex. Certain collective ownership forms may, in fact, approach private ownership, and even the nature of SOEs is changing as they are converted into joint-stock companies. Yabuki and Harner examine those complexities throughout the book (see, for example, Yabuki's discussion of SOEs in chapter 14, TVEs in chapter 16, and FIEs in chapter 27 and Harner's analysis in chapters 20 and 21 of the effect share markets are having in restructuring SOEs and disciplining enterprise management). According to Harner, "Even when the state continues to hold a majority of shares in an enterprise after its listing, which is usually the case, new disclosure requirements and public accountability have a profound and positive effect on the enterprises' managers" (p. 184). The problem, however, is that so long as the state has a large stake in enterprise ownership, there will be an incentive to politicize decisionmaking and depart from profit maximization. The poor performance of the "Red Chips" in Hong Kong illustrates this problem. "Disclosure" and "accountability" still have a

long way to go in China's new political economy (see chapter 23, in which Harner addresses the serious shortcomings in China's investment system).

There is much else in this book that the reader will find helpful in understanding the changes that are slowly moving China toward a real market system and the barriers that remain. For example, rural workers are responding to wage signals and moving to higher paying jobs in the coastal areas, which is helping to bring about a more efficient use of labor (p. 99); SOEs face a pension crisis and must find ways of lowering costs to stay viable (p. 127); nonperforming loans on the books of state-owned banks now account for "30–40 percent or more of the banking system's assets," making bank reform essential (p. 178); China's accession to the WTO will have a positive impact on the growth of the nonstate sector (p. 238); and accession will eventually lead to the removal of capital controls, which have failed to prevent capital flight. As Harner notes, "Chinese balance of payments figures are 'soft' and . . . China's capital account is not really as 'closed' as the government would hope" (p. 253).

The only shortcoming of this book is that it ends with 1998. Thus, there is no mention of the U.S.-China Relations Act of 2000, and there is insufficient information on the status of China's accession to the WTO. Moreover, the book's statistical series do not go beyond 1997. Nevertheless, the book is still largely "current" and descriptive of the reality and issues of today.

I look forward to the authors' next edition, in which they can take account of the relevant changes since 1998 and further update China's slow journey toward a real market system. In the meantime, I strongly recommend their current edition as a valuable reference source on China's new political economy. There is no other book that presents such a wide variety of information about China's economic and political system in such a useful way.

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