CHAPTER 7

THE COLOR OF THE CAT

China's Transformation

WHEN THE FRENCH LINER docked in Marseilles in December 1920, most of the group of Chinese students on board stood about dazed, confused, not knowing what to do. One, however, was immediately busy, organizing their luggage, arranging their disembarkation. The young man, just sixteen, was Deng Xiaoping, and he was already demonstrating the take-charge organizational skills that would make him the dominating figure in China sixty years later. In the last two decades of the twentieth century, he would set his country on a course to create a capitalist economy within a communist political system and turn it into a major force in the global economy. This was remarkable in that he was seventy-four when he finally became the paramount leader and launched China on its era of reform. No less remarkable was the extraordinary resilience he displayed in the face of the enormous setbacks, challenges, deprivations, and falls from favor that preceded his final rise to power.

Deng was the son of a prosperous landowner-turned-local-government-official in the populous inland province of Sichuan. As a boy, he started in a traditional Confucian school, but then, amid the tumult and fragmentation that followed the Chinese Revolution of 1911, switched into a school equipped with both a more modern curriculum and links to France. That is how he came to be sent to France for further study. His education there proved to be spotty, and he held a number of jobs, working in a Renault plant and steel and rubber factories, and also doing time as a kitchen hand and as a fireman on a locomotive. He developed two lasting passions in France—one was for croissants; the other was for communism. The two were not totally unconnected: It was Ho Chi Minh, later the leader of North Vietnam, who would tell him where in Paris to get the best croissants.

The spread of communism among the handful of Chinese students in Europe was inspired by the May 4 Movement in Beijing, which had erupted in Tiananmen Square on May 4, 1919, to protest the humiliation of foreign domination of China in the aftermath of the Versailles treaty. Communism became a powerful vehicle for Chinese nationalism. For Deng it became a vocation. One of his chief sponsors and mentors was Zhou Enlai, who had imbibed Marxism while a student in Japan, before moving to France and becoming a leader of the tiny Chinese communist movement in Europe. Years later Deng was to call Zhou "my elder brother," and Zhou, as a good older brother, would shield Deng from the worst excesses of the Cultural Revolution of the 1960s. During their French student days, Zhou put Deng in charge of producing the communist newsletter, which led to his being jokingly granted a Ph.D. in mimeographing. In February 1926, the French raided the house where Deng lived, but they were too late. He had left for Moscow the day before.

In Moscow, Deng studied at the University of the Toilers of the East and Sun Yat-sen University. These were the days when China's nationalists and Communists were collaborators and not yet enemies. Their shared objective was China's modernization and renewal. The Comintern, Stalin's international apparatus, was teaching the nationalists how to construct a revolutionary party, and members of the Chinese Communist Party were also active nationalists. Wealthy nationalists were financing the training of young revolutionaries in Moscow who would restore China's dignity. Among Deng's fellow students was Chiang Ching-kuo, son of the Nationalist Party leader Chiang Kai-shek. Much later, in the 1980s, the younger Chiang would succeed his father as president of Taiwan.

Deng returned to China a convinced communist, prepared to dedicate his life to the revolution. His organizational skills quickly carried him forward. By the age of twenty-three he was chief secretary of the Central Committee of the Communist Party and then became an organizer in the countryside. China was in violent disarray. Warlords were battling for control of various regions, and the nationalists' alliance with the communists broke down as they competed for power. The Communist Party itself was riven by deep factional splits that spilled over into bloodshed. Deng, following Zhou, allied himself with the faction led by Mao Zedong. At one point, Mao's enemies within the communist movement imprisoned and interrogated Deng, probably tortured him, and repeatedly tried to force him to recant political "crimes."

Deng was part of the Long March of 1934–35, the six-thousand-mile trek that Mao led to escape the nationalists. Over its harrowing course, the communists were decimated. The march began with ninety thousand communist soldiers and ended with a paltry five thousand. Yet that experience was to provide the myths and cohesion that, within a decade and a half, would help to carry the communists to victory and rule over all of China.

The Japanese invasion of China in 1937 created the circumstances for the renewal of communist power vis-à-vis the nationalists. That war also turned Deng into a soldier. Once again his organizational talents brought him to the fore, first against the Japanese and then against the nationalists after 1945. He became one of the most prominent military leaders; indeed, he played a key role in the Huai-Hai campaign, which broke the back of the nationalists in 1949. This battle, which destroyed a nationalist army of five hundred thousand, is considered one of the most important land battles of the twentieth century. Deng's wartime role enhanced his credibility as a leader and established a network of relationships and connections that would bolster his political position and—at crucial times—protect him.

During his wartime administration of the Taihang region, in northwest China, Deng also laid out a set of pragmatic economic precepts that would prefigure his policies of the 1980s and the 1990s. Economic incentives were appropriate. "Some comrades say this is too much, but I don't agree," he told senior cadres during the war. "If they've acquired it through their own labor and not corruption it's entirely appropriate. Those who are lazy and unenthusiastic should suffer." Economic change should come gradually; people should feel the benefits directly. And—of critical importance—socialism depends upon proper organization and economic strength, and must be built upon "capitalist production." In other words, capitalism was not the total enemy of socialism. But where Deng did not waver was in seeing the party as the necessary instrument of modernization.[1]

Catching Mice

After the victory over the nationalists in 1949 and the establishment of the People's Republic of China, Deng emerged as one of the most senior leaders of the Communist Party. He became secretary-general and number four in the hierarchy. When Mao led a delegation to Moscow in 1957, he pointed Deng out to Nikita Khrushchev, the Soviet leader, and said, "See that little man there? He's highly intelligent and has a great future ahead of him."

Deng, for his part, remained deeply loyal to Mao, though he stood aside when Mao launched the Great Leap Forward. It was supposed to channel the enthusiasm of the "masses" so that China could do in fifteen years what the capitalist nations had taken 150 years to accomplish—and to secure complete control over the countryside. Farmers throughout the country were herded into regimented communes, and backyard pig iron furnaces became the symbols of the Great Leap. As it turned out, however, it proved to be a great leap into disaster. Undertaken without any regard for fundamental economics, it did nothing to advance China's economy. On the contrary, tens of millions of people died of starvation as agricultural and industrial production and internal trade—all totally disrupted—plummeted.

Deng was one of the chief figures who had to pick up the pieces. Gradual investment was to replace mass mobilization; education and expertise were again to be respected. It was at this time that Deng, not known for his aphorisms, made his most famous statement: "It doesn't matter whether a cat is black or white so long as it catches mice." Although he himself would later say he was not sure exactly what he had meant, it was very clearly an affirmation of pragmatism in economic policy in the aftermath of the fanaticism of the Great Leap. It was also a phrase that would find resonance around the world.

This pragmatism was held against him in the mid-1960s, when Mao launched the Cultural Revolution. Mao was deeply dissatisfied with the lack of ideological zeal in the country, and apparently very angry that he was no longer receiving the veneration due him as the paramount leader. Mao complained that Deng and his colleagues "had treated me like I was their dead parent at a funeral." In revenge, Mao mobilized young people in a savage assault on the established order. The number-one target of the Cultural Revolution was the party. This was heresy to Deng. For him, the united Communist Party was the foundation of China's regeneration. The chaos of the Cultural Revolution threatened everything he had devoted his life to since the early 1920s. Once offered a copy of Mao's Little Red Book, the bible of the Cultural Revolution, Deng unceremoniously turned it away. For his part, Deng was attacked as a "capitalist roader" and subjected to intense abuse; he spent two years in solitary confinement. He and his wife were both put to work in a tractor repair plant. His son was paralyzed as a result of a physical assault by Red Guards. What saved Deng from even worse was the network he had established through the army and his personal camaraderie with his "elder brother," Zhou Enlai.

In the early 1970s, after the Cultural Revolution had run its course, he came back into the leadership. During his time in confinement, he had spent many hours pacing the courtyard, asking himself how modernization had failed and how it could be restored. Now he could put his hard-earned conclusions to work as he helped direct the economic recovery. He returned to the principles he had favored before—education and economic incentives rather than ideology and exhortation. But criticism mounted against Deng for bowing to capitalism, and once again, with Mao against him, he was stripped of power. The death of Zhou made Deng's position very precarious, and he was forced to sign yet another self-criticism. He was portrayed as everything evil—from a counterrevolutionary to a "poisonous weed" who was trying to undermine the glorious revolution. But again his old comrades from the army shielded him.

The death of Mao in 1976 liberated Deng. The "Gang of Four" (including Mao's wife), who had masterminded the Cultural Revolution, were arrested, and Deng returned to the center of power. He immediately became engaged in the bitter struggles that followed Mao's death. Hua Guofeng was Mao's designated successor. "With you in charge, I'm at ease," Mao had told Hua. Deng, however, challenged Hua, who was known as the "chief whateverist." ("Whatever decisions Chairman Mao made, we resolutely support," said Hua. "Whatever instructions Chairman Mao made, we will steadfastly abide by.") If he was to have his moment, Deng realized, this was it. He carried out the battle against Hua with every resource available to him. By the end of 1978, Hua was out, and Deng emerged as China's paramount leader. Yet again he was in the position of picking up the pieces. Out of them he would lay the foundations for China's real great leap forward.

In subsequent history, December 1978 has come to rank with 1911—the Chinese Revolution—and 1949—the communist victory—as one of the great turning points in twentieth-century Chinese history. The Third Plenum of the Eleventh Congress of the Chinese Communist Party assembled that month, and although a series of major decisions was made in the months before and after, the plenum encapsulated the fundamental decision: to reorient China toward the market.

There was no grand plan, but rather certain practical steps. In their entirety, they reflected a break with Maoism. The shift bore Deng's imprimatur. Whatever worked economically was more or less all right with him—as long as the party remained in control. Results were what counted. Deng wanted to create a wealthy and powerful China, not a utopian or messianic paradise. He was a nationalist, and communism and the party were the mechanisms by which to reach that objective. And behind it all was a straightforward decision. "I have two choices," said Deng. "I can distribute poverty or I can distribute wealth." He had seen enough of the former under Mao.[2]

The Reform Begins

The initial reform effort centered on agriculture. Mao's collectivized agricultural system had produced dismal results. Output in many regions was no greater than it had been at the time of the communist victory three decades earlier, and in some cases it was actually less. Despite the investment and the use of new techniques, productivity was no higher under collectivization than it had been under China's old medieval system.

But it took a local crisis to begin replacing the old system. China's entire economic reform began with rainfall—or, more correctly, lack of it. Anhui province suffered a severe drought in 1978—the kind that was said to happen no more than once in a century. The ground was so dry that neither tractors nor plows could break it. Starvation became endemic. Dysentery, encephalitis, hepatitis, and other diseases swept through the region, and as hundreds of thousands of people fled from their homes, the militia mobilized to try to prevent them from flooding into Shanghai. A film of the suffering was shot. Shown to members of the Politburo, it made them "cry out, cover their faces with their hands, and weep." The only way to break through the parched land was through the hardest personal labor. But the peasants would not do it unless they could benefit. They appealed for the return of the "old ways." By this they meant what came to be called the household responsibility system, earlier versions of which had been tried at various times during the history of the People's Republic—and which allowed a family to keep some of the benefits of its labor. The peasants got their wish and the system was implemented. Desperation drove the decision. Even so, the first peasants to sign on insisted upon swearing a common oath to take care of each other's children should they "come to grief" by being arrested for participating in the new program.

Their fears were more than understandable given what had happened during the Cultural Revolution. But the outcome this time was different. The experiment proved successful and was widely approved. The responsibility system was thereafter adopted throughout the country, and material incentives replaced the Maoist strictures. The commune system and collectivization were undone; each family was responsible for the land it tilled. Peasants had to deliver a certain amount of their production to the state; above that, they could keep the output, consume it, or sell it. With that, free enterprise was launched.

The results were stunning. Over sixteen years, output increased more than 50 percent, something that had completely eluded the Maoist system. The introduction of markets in agricultural products instantaneously generated an entire trading apparatus; farmers involved themselves in transportation, house building, repairs, private food markets, and hiring workers. In short, these changes created a whirlwind of entrepreneurship. In 1978, just 8 percent of agricultural output was sold in open markets; by 1990, the share was 80 percent. Between 1978 and 1984, real income in farm households rose 60 percent.

The rapid improvement in agriculture was the beginning of China's economic reforms. The success in the countryside created a pro-reform constituency not only among farmers but also among city dwellers, who could find more food and more variety in the marketplace; it thus provided momentum for the next steps. Gradual decontrol of prices also began at this time. Although what Deng wanted was results, not lessons, there was herein a very important conclusion. As the economist Dwight Perkins put it, "The political lesson for future reformers from China's experience is obvious but often forgotten—try to begin the reform process with a clear winner."[3]

"Bird in a Cage"

Agriculture proved easier to reform than industry and the urban economy. Farming was essentially a local matter. Improvisation—"crossing the river by feeling the stones"—could be tolerated. Not so with the industrial sector. Industry was interconnected: It was controlled from the center, the scale was large, and it generated much of the government's revenues. It was key to the state's financial solvency. Thus, any change in the system could throw the entire country into economic disarray. Moreover, the focus of Marxist economics was industrial production; in both the Soviet Union and China, the agricultural sector was exploited to support heavy industrialization.

Still, the highly inefficient industrial sector was in desperate need of reform, and as a result, a major and acrimonious debate unfolded over the relationship of state and marketplace. The irrationalities of the system were candidly discussed. For instance, it was argued that the way the state collected revenues from enterprises ended up "whipping the fast ox"—that is, punishing firms that were more efficient. The higher the firm's profits, the greater the proportion of profits that went to the government. There was much discussion about increasing the autonomy of enterprises and moving to some system of market socialism. Yugoslavia's self-governing firms were seen as a model. But the state was still to be dominant. The "plan" would rule. The Wuxi conference in 1979 brought economists and party cadres together to discuss these issues. Two economists summed up the prevailing attitude in saying that China "cannot allow Adam Smith's 'invisible hand' to control our economic development." For "if individual consumers in the market make decisions based on their own economic interests, this will not necessarily accord with the general interest of society." Planning had to be made more effective, but that was not the same as giving over to the "blindness" and "anarchy" of capitalism.[4]

While some movement was made toward granting firms more independence, reform in the industrial sector was stifled for several years by conservatives—conservatives of a sort, that is. They were led by Chen Yun, a party elder like Deng. Chen had joined the party in 1925, at age twenty. He had organized both peasants and workers in Shanghai, and had spent some time in Moscow as part of the Chinese delegation to the Comintern. In contrast to Deng, Chen's forte was economics, not politics. He had held senior planning positions since the late 1940s, and although at times he had been one of the few in the leadership who dared to disagree with Mao's economic nostrums, he came to be seen as the party's leading expert on economics. He was disparaging about both the Stalinist economic model and Mao's efforts to replace economics with the enthusiasm of the masses. Like Deng, he was purged during the Cultural Revolution. Rehabilitated before Deng, he was among those who urged that Deng be returned to the leadership. The experience of the Cultural Revolution confirmed Chen's conviction in favor of steadiness and his opposition to "rashness." He was a technocrat and a socialist and a fervent believer in planning. He was vigorous in his criticism of "the petroleum group," the economic managers who simply wanted to pour more and more resources into heavy industry—the classic socialist ailment of "production for the sake of production." But he had no desire to introduce a full-blown market system, nor was he keen to attract foreign investment. He warned that "foreign capitalists are still capitalists," out to make a profit; and he despaired that "some of our cadres are still very naive about this." He worried about foreign "pollution" of Chinese socialism and feared the effects of the shortages, inflation, and dislocations that would come, he was convinced, with a shift to a more market-oriented economy and the resulting "rashness" of high growth.

Chen Yun was unhappy with central planning to date, but he did not believe a country as large and poor as China, with limited resources, could jettison planning. He wanted to improve it—make it more scientific and more balanced. He was interested less in reform than in "readjustment." In his words, the "whole country [was] a chessboard." Chen and the other planners at the center would be in charge of moving the pieces rationally and methodically. In short, the planned economy was "primary" and it should remain primary. While a market economy providing less essential elements had a role to play, that role was very definitely "secondary" and supplementary. Yes, the market was useful, but it was also dangerous.

Chen summed up his attitude to visitors who came to his house at the end of 1982. The relationship between improving the economy and economic planning was like that between a bird and its cage. "You mustn't hold the bird in your hands too tightly or it would be strangled," he said. "You have to turn it loose, but only within the confines of a cage. Otherwise it would fly away."

This became known as the "birdcage thesis," and Chen and his allies were intent on keeping the bird in its cage. The "readjusters" largely carried the day in the early 1980s, bolstered in their efforts by other factors that prompted caution. First was the sudden emergence of Solidarity in Poland in 1980, which raised alarm among Chinese leaders. If they did not exert care, said Chen, and "did not pay attention to the two issues of propaganda and economics, then events like that in Poland could happen in China, too." Second, the leadership was caught up in debate and uncertainty over how to deal with the legacy of Mao. There was also a limit to how much change the system could withstand. Deng went along with the more conservative readjusters because of the threat to the party, whose "stability and unity"—and unchallenged dominance—were at the heart of his politics. Such a party was essential to the central goal of modernization. "Without such a party," said Deng, "our country would split up and accomplish nothing."

But by the mid-1980s, the "go-slow" argument was losing its credibility. The economy was growing much faster than anticipated without the severe problems that Chen Yun had forecast. Agriculture was achieving considerable success. As surprising as the improvement in agriculture was the great stimulus it had given to the emergence of rural industry and commerce. Reform now had both a constituency and a track record. Moreover, the Chinese were no longer looking at Yugoslavia, which was experiencing economic difficulties, or at Poland, where Solidarity had been outlawed, but rather at Hungary, which was experimenting more actively with market mechanisms. They read the works of the Hungarian economist János Kornai, who at this time was also beginning to have much influence on young Russian reformers.

The most dramatic lesson, however, came from closer to home. The Chinese were also waking up to the fact that Japan had become an economic superpower. Visiting Japan and seeing its dynamism firsthand shocked the Chinese communists. No less a figure than the head of the propaganda department of the Chinese Communist Party noted truly astonishing things in his report: One out of every two households in Japan owned an automobile; more than 95 percent of households possessed television sets, refrigerators, and washing machines. He was also overwhelmed by how people were dressed—by the variety of clothing and its cleanliness. "One Sunday we went out to a busy street. Of all the women we saw, no two wore the same style of clothes."

He added something even more astonishing: “The female workers accompanying us also changed clothes every day.”[5]

“Socialism with Chinese Characteristics”

The mid-1980s was the turning point for the Chinese economy, the time when it indeed entered into high-speed growth. The leadership under Deng embraced economic reform and liberalism even while striving to maintain political control. “Some of our comrades are most worried about whether we will become capitalist,” Deng declared. “They are afraid of seeing capitalism suddenly looming up after having worked all their lives for socialism and communism, and they cannot stand such a sight.” Deng sought to reassure them. He described what was happening as the “building of socialism with Chinese characteristics.” That became the title of a book he published at the end of 1984.

No doubt, he had Chen Yun more than anybody else in mind in his criticism. They were the two elders, veterans who had joined the party at almost its very beginning. They had both risen to senior positions, only to be purged and humiliated during the Cultural Revolution. They had come back together as allies, intent on redressing the deep wounds of Maoism. But increasingly they had become rivals. Chen believed that Deng took too much credit for himself and that he, Chen, was being denied due credit for helping shape the original reform package. Their struggle would describe the terrain of reform. Their disagreements began over such matters as whether peasant farmers could hire extra laborers. To Deng, it was simply a pragmatic matter, and he supported it. To Chen, it represented a return to capitalism in the countryside, and he was opposed. Deng carried the day, although the term “hired labor,” with its Marxist connotation of exploitation, could not be used. Instead, it became “asked-to-help labor.” By the end, their battle was over nothing less than what kind of future China could attain.

But what did the “building of socialism with Chinese characteristics” mean? From 1984 onward, debate about the future of the Chinese economy began to move beyond Marxist categories to a discussion of how to create a market economy. It was a decisive turn. The market, some factions now began to argue, would do a better job of allocating resources than planning had done. Increasingly, economic data competed with Marxist catechisms in the fashioning of arguments.

The result was a continuous, complex, and acrimonious debate, pitting not only devotees of central planning and the socialist tradition against reformers but also reformers against other reformers. As the debate accelerated, some who had been reformers in the late 1970s became, by the mid-1980s, the conservatives. If Deng was the paramount leader of reform, then Chen was the paramount critic. The issues were enormously complicated: How was the huge economy to be transformed? How could an economy that was partly command and partly market, with two different price systems, move forward? Did reform and high growth inevitably mean overheating and high inflation? At the heart, of course, was the question of the proper relationship of state and market.

For the conservatives, the danger was not only dislocations and inflation but also chaos and loss of political control—which Deng feared. The conservatives wanted to reassert centralization, stabilization, and mandatory planning. The reformers wanted to reduce the control of the center and party secretaries and instead make enterprises responsive to market signals. The reformers got partway there with the introduction of the "contract responsibility system," which, echoing the "household responsibility system," allowed state enterprises to keep earnings above a certain target. By December 1987, 80 percent of China's large and medium-size firms had adopted such a system.

But it was not enough. These state firms remained inefficient. They were losing out in the growing competition from new companies established by local villages and towns. The two-track system of prices stimulated inflation and encouraged corruption. One prominent economist, Wu Jinglian, cited Ludwig Erhard (and the 1948 German currency reform) and Milton Friedman in calling for a massive price reform. But Wu still subscribed to the widely held belief that large and medium-size enterprise was the "backbone" of the economy and insisted that the government must play the central guiding role in the economy. If China were to introduce "a type of economic mechanism reminiscent of Manchester capitalism of the nineteenth century," he said, the result would be "historical retrogression."[6]

Another prominent economist, Li Yining, challenged the entire premise of state control. He had begun as a follower of Oskar Lange, the Polish economist who had advocated market socialism with a system of state ownership. But during the years of the Cultural Revolution, Li thought back on the debates between Hayek and Lange and concluded that he had come out on the wrong side and that Hayek had been more correct than Lange. The Soviet economic model could not work. The most important—and the most required—reform was the creation of property rights. Only ownership could introduce responsibility into decision making and channel motivation. How far the debate had moved—from Marx and Stalin and Mao to Friedman and Hayek.

Reform and Retrenchment

As for Deng, his interest was in results—China's wealth and power. He wanted to make up the wasted years. Party general secretary Hu Yaobang, a strong reformer, had Deng's support until Deng—pressured by Chen, who regarded Hu as too liberal—purged him. The mantle of reform was then taken up by Zhao Ziyang, who was premier and then became general secretary. In order to sell reform as something other than the repudiation of socialism and the embrace of capitalism, Zhao emphasized the imperatives of the "new technological revolution." He read Alvin Toffler's *The Third Wave,* which was about the impact of information technology, and vigorously urged other people to read it as well, in order to understand what China was missing.

Zhao had been propelled into the leadership by the success of his reform program in Sichuan, Deng's home province. In turn, Zhao also became the chief proponent of the "great international cycle of development." The idea was to quickly build up new industries geared to export, particularly in the coastal areas. This approach meant adopting the Asian export-led growth strategy that the Chinese could see working all around them. It offered the solution to multiple problems. These new industries would earn hard currency, and they would absorb surplus labor coming out of the agricultural regions in the country's interior. "China should seize the current opportunity," said Zhao, "take part in international competition, and push the coastal areas into the international market."[7]

At the center of the strategy would be the Special Economic Zones (SEZs). They, more than anything else, engendered China's engagement with the world economy. The original SEZs were created in 1980. Three were established in Guangdong province, including Shenzhen, across from Hong Kong, and in Fujian province, across from Taiwan. Their whole orientation was outward; they were export-processing zones, and they were the magnet by which to draw in foreign investment. Beijing gave local authorities in the SEZs unprecedented autonomy in trade and investment decisions. The concept was expanded to a number of cities in the mid-1980s. From then on, the coastal cities drove the Chinese economy forward.

For all the success of the SEZs, accelerating inflation fueled a conservative backlash that by the end of 1988 had forced Zhao and his allies to go on the defensive. The conservatives attacked the opening to the outside world. "We must not think that the moon in foreign countries is fuller than in China," declared one conservative. Another warned that there were "some people who wanted to go toward bourgeois democracy, as if the moon in bourgeois democratic society were brighter than our sun." There was even a "Mao Zedong craze," which combined attacks on reformers and the current leadership with nostalgia for the old order.

The specter of capitalist-style crime and corruption—along with materialism and the appearance of inequalities—also drove the reaction. "Honest people can barely make a living," said one economist, "whereas opportunists and the corrupt live in abundance and are envied by others. Nothing corrupts the moral climate in society more than this." Other substantial economic issues emboldened the conservatives. The big state enterprises were losing out. Adaptation was enormously difficult, and their losses were mounting, which meant that the government's revenues were falling precipitously.

Deng remained reform's number-one cheerleader. He backed plans for a massive new price reform. "We are not afraid of stormy weather but will pass all the hurdles braving the wind and the waves," he said. But all that changed in August 1988. Anticipation of a price reform ignited a run on banks and a panic buying of goods. Deeply shaken, the government—Deng included—abruptly changed course. Now the focus was on economic stabilization and retrenchment, not new reforms.[8]

Tiananmen Square

But there were unexpected political consequences. The economic difficulties, the conservative turn, and the thwarting of democratic aspirations strengthened a "democracy movement" among students. Thousands of them, mourning the death of the purged reformer Hu Yaobang, occupied Beijing's Tiananmen Square in April 1989. To conservatives, it was an act of rebellion, the consequence of ten years of too much reform and too little control. To those like Deng, it challenged the sacred precept: the supremacy of the party, which was the bulwark against disorder and chaos. It also reminded Deng too much of the Cultural Revolution and its militant students. He was the core leader, and the core of modern China was in danger. Survival and order took precedence over reform. The risks were evident, for communism was collapsing in Eastern Europe. "Concessions in Poland led to further concessions," an angry Deng declared. "The more they conceded, the more chaos." And chaos was the enemy. Tiananmen Square was a frontal challenge—not only because of its visibility and physical location but also because of its key location in modern Chinese history. It was there, forty years earlier, in 1949, that Mao had proclaimed victory and the establishment of the People's Republic of China. And thirty years before that, on May 4, 1919, it had been the scene of the nationalist student demonstrations that had helped give birth to the Communist Party. At the beginning of June 1989, the order was given to the military to clear the square. About a thousand people are thought to have been killed in the ensuing struggle.

Retrenchment and controls were stepped up. The collapse of communism in Eastern Europe, Mikhail Gorbachev's talk of multiparty democracy in the Soviet Union, the attempted coup against him, the rise of Yeltsin—all this reinforced the Chinese conservatives' drive to rein in reform and reassert control. Economic growth slowed and dissent was stifled. Deng was still the paramount leader, but reform was in retreat, and so was his influence. His old rival Chen Yun was in ascendancy again, and Chen's denunciations of the market and his embrace of central planning were trumpeted. He declared that the "proper ratio" of planned economy to market economy was eight to two. "Chen Yun Thought" was now celebrated in a way all too reminiscent of the adoration given to Mao Zedong Thought. Chen spoke nostalgically of how Mao had "talked to me three times about studying philosophy" and recommended reading the works of Marx, Engels, Lenin, Stalin, and, of course, Mao. And Chen attacked Deng directly, charging that his policies were responsible for the trends that had culminated both in the overheated economy and in the events in Tiananmen Square. Chen and his allies singled out the Special Economic Zones along the coast for some of their most violent criticism, charging that they were capitalist in character and conduits for forces that would destroy communism in China.[9]

The Nanxun: *Deng's Last Campaign*

But Deng would not give up. Everything he had tried to accomplish over the last fourteen years now seemed at risk. Three times before in his career as a communist, he had been pushed onto the defensive, disgraced, forced to recant. It would not happen again. He would respond in kind, confronting his enemies on the very terrain they had denounced. In January 1992, even as the conservatives appeared to be consolidating their position, the eighty-eight-year-old paramount leader set out in his private railway car on yet another campaign. He headed south. It was called his *nanxun,* or "southern journey," and it lasted a month. It would be his last campaign.

His enemies had attacked the Special Economic Zones, which he had sponsored. He would defend them by going there himself. The most important destination was the Pearl River delta in Guangdong province and, in particular, the Shenzhen SEZ, which borders Hong Kong. He gave speeches, met local officials and businesspeople, posed for photos, even shoveled dirt at a construction site. What he saw was enormously changed from what he had viewed in 1984, when Shenzhen was still very much a rough, unfinished city in the making. Now it was a modern high-rise urban area. Deng said he would never have believed that such changes were possible. "Having seen it, my confidence has increased." Yes, he said, many problems had resulted from the much-criticized growth period, 1984–89. But the results had been stunning. It had been a "flying leap"—the real great leap forward. Shenzhen was no longer an experiment; now it was the model for the future.

The man who would not distinguish between black cats and white cats similarly dismissed the catechistic distinctions between capitalism and communism. "Market economies need not be surnamed capitalism," Deng said. "Socialism has markets, too. Plans and markets are simply economic stepping stones . . . to universal prosperity and riches." He had one other very important message: It was not the reformers but Chen Yun and his allies who could be the destroyers of socialism. In what would prove to be his most widely quoted remark from the *nanxun,* Deng urged his fellow party members to "watch out for the Right, but mainly defend against the Left." Commenting on his elderly opponents' opposition to change, he said that old age made people stubborn, and if such people could not show more flexibility and openness in their thinking, then they really ought to "go to sleep." Replying to Chen's recent reading list of communist classics, Deng offered the stunning revelation during his *nanxun* that he had never bothered to read Marx's *Das Kapital.* He had had neither the time nor the patience.

The response to the trip demonstrated how severe the struggle was. In the first month, in fact, there was no response—no newspaper reports, no film, no commentary. Silence. Deng's opponents were strong enough to make it seem a nonevent. But then word filtered from Shenzhen through Hong Kong and back to the mainland. After a month's delay, the nonevent turned into a decisive event. The *nanxun* became the subject of extensive press coverage and much discussion. With the economy still gripped by recession, Deng's message found wide resonance; indeed, it changed national policy. It was Deng's final victory. Support for Chen's position began to fall away. Replying to Chen's calls for severe restrictions on the SEZs, one vice-premier sarcastically advocated the introduction of "special Leftist zones," to which the hard-line Marxists could be sent. "Let us carve out a piece of land where policies favored by the Leftists will be practiced," he said. "For example, no foreign investment will be allowed there, and all foreigners will be kept out. Inhabitants of the zone can neither go abroad nor send their children overseas. There will be total state planning. Essential supplies will be rationed and citizens of the zone will have to queue up for food and other consumer products." He urged the leftist critics to sign up for their places without delay.

Deng's campaign culminated in the fourteenth Party Congress in the autumn of 1992, which affirmed a new commitment to reform. It hailed Deng's "brilliant thesis"—that China should shift from a "socialist planned commodity economy" to a "socialist market economy." Reform was back on track. It was Deng's final victory. At age eighty-eight, he had reaffirmed, once again, his position as the paramount leader.[10]

The Two Economies

With his trip, Deng wanted to convey a specific message about China's future. Guangdong, he said, was the head, the engine, of China's reforms. And the province, he added, should accelerate its reforms so that it could overtake the four tigers—Korea, Taiwan, Singapore, and Hong Kong—within twenty years. He was, in fact, pointing to the basic reality of China's future economic development. China's overall record would be remarkable. Between 1989 and 2000, the economy grew at an average annual rate of 9.7 percent. During that period, it also moved an enormous distance from being a Soviet-style command economy toward being governed by market forces.

But that growth record concealed a deep divide between state and market. On one side of the divide were the state-owned enterprises, middle-size and large. They were also complex social systems, providing a full range of social and welfare benefits to their workers. The large state companies numbered about ten thousand; their labor forces ranged from five thousand to, in some cases, five hundred thousand. A few made headlines by managing to free themselves from these obligations or carry them out in less onerous ways. But the bulk of the large companies were wasteful and highly inefficient; they produced goods that were not matched to demand; they drained financial resources out of the national budget instead of putting them in. They did not pay their debts. Yet because of their political clout and their social role, they were not easily reformed. By some estimates, three quarters of them lost money. They lacked financial discipline and were not responsive to market signals. Their senior managements, in the words of one Chinese steel executive, were "too tired to take care of their businesses. They spend their time managing their employees' housing, the children's schooling; they take care of their workers' grandmothers." A good part of China's recurrent inflation was attributed to their ability to extract credits from the state on unsound financial criteria. Tied in with them were the state-owned banks, with their huge portfolio of nonperforming loans.

On the other side of the divide was the new economy, the source of growth and dynamism. Not all of it was private. "Collective" enterprises, owned by villages and localities and the army but run by entrepreneurs, emerged to become one of the main drivers of economic growth. They represented alliances of entrepreneurs, local officials, the military, and enterprise managers, and absorbed the labor let loose by the increased productivity of agriculture and the tightening constraints on traditional state companies. They received little in the way of subsidies, they competed with firms from other provinces, and they responded to market rules. These firms, not the large state industrial enterprises, have proved to be the real backbone of China's economic growth. They also created constituencies with strong local roots for openness and reform.

Foreign investment plays a significant role in China. From 1990 through 1997, the annual flows grew more than tenfold, from $3.7 billion in 1990 to more than 41 billion in 2000. This growth is all the more striking in that it has taken place in a foreign-investment system that has not been wholly inviting. Indeed, it is not firmly fixed at all. The Cultural Revolution abolished lawyers and most commercial laws, and there does not yet exist the kind of contractual, legal framework—or the clear-cut decision making—that most foreign investors seek. Yet despite the insecurity, the inflow of foreign investment continues to grow. "The lure of a billion-plus customers can offset many worries," said Dwight Perkins.

The greater part of foreign investment has derived from ethnic Chinese, and a good deal of that has been oriented not to the domestic market but to exports. Indeed, the investment insecurity has favored investment by the overseas Chinese. They tend toward smaller investments with quicker payback periods. They do not have to worry about twenty-year contracts. The fluidity and lack of well-defined legal systems also put a premium on what is to the advantage of the overseas Chinese—*guanxi.* These are the informal connections that tie overseas Chinese to friends and relatives on the mainland and that operate not only at the high levels but right down to the local neighborhood. Western and Japanese businessmen may well find themselves received in the highest precincts of the Chinese establishment, but they cannot begin to match the overseas Chinese in terms of the *guanxi,* which get the job done. Nowhere has this been clearer than in the case of Guangdong province.[11]

"A New Tiger"

As Deng emphasized on his *nanxun,* nothing could compare to the frenetic growth on the southern coast in Guangdong province, and in particular the Pearl River delta. Guangdong and neighboring Fujian were selected as the provinces to house the first SEZs not because they were already well developed. On the contrary, they were backwaters with little industrial development. Mao had shortchanged them, instead concentrating resources on building up the internal economy far away from the coast, which he feared would be vulnerable to military attack. The two provinces were chosen because they were distant from key cities such as Beijing and Shanghai and thus, it was thought, "contamination" from the outside world could be limited. They were also, of course, on the coast, which would facilitate exports.

By looking outward again, Guangdong was reconnecting to its past. Merchants from Guangdong had dominated Southeast Asian maritime commerce until this trade was banned in the sixteenth century by the Ming dynasty. When the ban was lifted in 1685, it was too late. Although trade revived again, the Europeans dominated it and Guangdong never regained its historic prominence. But two factors were to prove decisive for the rebirth of Guangdong in the 1990s. The first was *guanxi,* which served Guangdong particularly well. Eighty percent of the 30 million overseas ethnic Chinese trace their origins to Guangdong, and they would invest billions in the province. The second was the strategic location of Shenzhen, which was adjacent to Hong Kong. That proximity would prove essential to the dramatic takeoff of the region.

The Pearl River delta, which makes up about a quarter of the total area of Guangdong and includes both Shenzhen and Guangzhou, has been described as the "crown jewel of the Chinese economy," a new tiger, and the "Fifth Dragon." Between 1978 and 1993, Guangdong's economy grew at 13.9 percent, well above the national average. The delta's growth rate was still higher—17.3 percent. Guangdong's external trade (exports and imports combined) totaled $175.5 billion in 2000—nearly 40 percent of China's total. Guangdong is the largest consumer market in China (even though its population ranks as fourth-largest among China's provinces and autonomous regions), with retail sales of consumer goods accounting for 12 percent of China's total.

This kind of sustained high-speed growth exceeded anything registered by any of the "Asian miracle" economies. And it was reflected in the changing landscape. Agricultural land was transformed into what seemed an endless boomtown construction site and then into modern high-rise cities. When Électricité de France, the French utility giant, built its $3 billion nuclear power plant in 1993 to help meet the burgeoning electricity demand, the site was a desolate waterfront, Daya Bay. Once a road was built to the plant, miles of what had been empty land turned into a vast series of new factories. Shenzhen itself, once a border post of some thirty thousand, grew to 3 million in less than twenty years. But a border still separated Shenzhen from Hong Kong, one of the original tigers.

"One Country, Two Systems"

Hong Kong was born of the Opium Wars, which set British traders against the Chinese Empire in the mid-nineteenth century. The island part of the territory was ceded to Britain in 1842, and by 1898 the territory had taken the frontiers that it was to have up until 1997. The revolution of 1912 that overthrew the Qing dynasty gave way to turbulent decades in which southern China was the terrain of battles among nationalists, communists, and warlords of varying allegiance. Hong Kong offered a secure trading outlet as well as a safe haven for assets of businessmen and industrialists. The communist takeover of 1949 cemented Hong Kong's role, as many of the traders and industrialists of China's economic capital, Shanghai, scrambled to move to the British colony. From this upheaval Hong Kong acquired a business community with advanced education, entrepreneurial skills, and connections to the mainland that would come, in time, to be very useful indeed.

Beyond these human resources, Hong Kong had little more than its strategic location, and particularly its deepwater harbor. In the same manner as Singapore, it came to live off trade. Until the communist takeover, it was a major conduit for China's imports and exports. After 1949, it turned toward exports farther afield; and the investment of displaced Chinese, combined with the availability of cheap labor, fostered a mushrooming of local assembly plants, textile workshops, and factories for light manufactures. These prospered thanks not only to the enterprising spirit of their founders but also to the unusually market-oriented business environment that the British administration let thrive. Politics in Hong Kong was of the clubby colonial sort: Opposition was permitted only in small amounts, the legislative council was for many decades appointed rather than elected, and the top administrators were British, sent over from the Colonial Office in London. But if political life was heavily regulated, economic life was decidedly freewheeling. The currency was pegged to the U.S. dollar, and capital was allowed to flow as it pleased. There were no trade or exchange restrictions, and there was no central bank. Labor legislation was light; taxes were very low. All of this contrasted with the other Asian tigers, in particular with the other entrepôt economy, Singapore. In Hong Kong, it seemed, the particular advantages of location and the accident of history that had brought enterprise and investment after 1949 acted as a substitute for government regimentation of economic life. The most powerful government figure was the finance secretary; and that post was occupied by a succession of administrators with explicit laissez-faire beliefs. The classical liberal system in the colony contrasted sharply—and ironically—with the mixed-economy system that prevailed back home in the United Kingdom.

In the 1960s, Hong Kong began to switch from the production of apparel and light manufactures to consumer electric and electronic goods. The economy was geared entirely toward exports on the basis of plentiful investment and cheap labor. Hong Kong–made products became ubiquitous on the American and European markets, threatening to displace traditional textile and manufacturing sectors in those countries. But Hong Kong's apotheosis in the global economy would come only in the 1980s. It was intimately linked to Deng Xiaoping's program of reforms on the mainland, which reopened the door to travel, trade, and investment across the border. By establishing the first Special Economic Zones near Hong Kong, Deng invited investment into the Chinese hinterland's vast pool of labor and resources. Hong Kong capital wasted no time in exploiting the opportunity. Manufacturers began to shift the most labor-intensive parts of their production onto the mainland. The fast growth of the SEZs lent even more texture to the increasingly dense urban fabric, turning the Pearl River delta into a real megalopolis, with Hong Kong and Guangzhou as its twin poles.

But the most dramatic change, and the one for which Hong Kong was to become best known, was its transformation into one of the world's preeminent financial centers. That change came about, in part, with the explosion of international investment finance in the 1980s. It was helped greatly by the climate of unbridled laissez-faire capitalism and the well-established presence of major trading houses, known as the *hongs,* many of them a century old, and large local fortunes seeking profitable investment outlets. But the changes in China contributed, here again, mightily. The relaxed restrictions of the SEZs meant that firms there were often free to raise capital on the stock exchange. Although China began to develop its own stock exchanges in the 1990s—at Shanghai and Shenzhen—the Hong Kong exchange was the foremost, logical place to list a company. In addition, as China's fast growth began to attract foreign capital in large quantities, Hong Kong became the center of investment expertise which helped channel that money onto the mainland. All this added to the colony's underlying role as semiclandestine conduit for money from the "renegade province"—and economic success story—that was Taiwan, as well as its formal and informal role as financial center for the overseas Chinese.

China itself began to take an interest, and indeed a financial stake, in Hong Kong's future well in advance of the political handover. By the late 1980s, China's state firms had invested heavily in Hong Kong's frenetic real estate market, and were beginning to take stakes in a number of its productive industries. The state-owned Bank of China built one of Hong Kong's most distinctive and dramatic harborfront skyscrapers. By the time of the handover, Chinese firms had interests in many of Hong Kong's important industrial conglomerates and in the private monopoly utilities that delivered much of the territory's public services. As jitters over the handover rose and then subsided in the early 1990s, the frantic rush of Hong Kongers to transfer capital away from the territory to such alternative homes as the United States, Canada, or Caribbean tax havens gave way instead to a stock exchange rush on the so-called red chips—Chinese state firms registered in Hong Kong but with tight financial and political connections to the mainland.[12]

On June 30, 1997, in accord with the 1984 agreement between China and Britain, Hong Kong was returned, culminating in a sober midnight ceremony in which, under a monsoon rain, the Union Jack went down and the Chinese flag went up. From the promenade of the new convention center that juts into the harbor, the display of fireworks across the water was extraordinary. It was a momentous event. It also posed momentous questions about future political developments and the nature of life in Hong Kong, and its relationship to both China and the rest of the world. Already before the handover, Hong Kong's wealth—in per capita terms, more than 20 percent higher than Britain's—contrasted uncomfortably with standards of living on the mainland. After the takeover, and despite the fast growth and increasing integration of the delta region, that contrast was made starker still by the difference in economic ideology, outlook, and regulations. Hong Kong property values, taken for granted there, certainly struck the rest of the world as remarkable—$100 million for a plot of land on which to build twelve condominiums. And the values on the Hong Kong stock exchange rested, in part, on such prices.

It did not take all that long, however, for Hong Kong to get into economic trouble. The source of the troubles was not meddling from Beijing but the global marketplace, from which Hong Kong had so long benefited.

The handover had occurred just prior to the beginning of the Asian economic crisis. Initially, it was thought that the well-run Hong Kong would be relatively immune. But several months after the baht collapse, Hong Kong's stock market crashed, property prices slid by 40 percent, and a rush to dump Hong Kong's currency threatened its peg to the U.S. dollar. A year and a half later, Hong Kong was in a recession, and its authorities were spending billions of dollars to intervene in the stock market to prop it up. But as the crisis receded and office spaces in Hong Kong's now-vacant high-rises started filling up again, an unanticipated benefit became apparent: The crisis had forced Hong Kong's economy to restructure. Although its businesses continued to be dominated by powerful tycoons, signs of more transparency became evident, and international accounting standards and legal contracts increasingly came to replace the traditional reliance on insider information and networks of overseas Chinese.

To a large extent, Hong Kong remains an offshore zone in China's economic life. Its per capita income alone, which at more than $22,000 per person exceeds that of Great Britain, will keep it as such for a long time. But economic ties, already strong before the integration, are deepening. Politically, too, Hong Kong is gradually becoming incorporated into the mainland. Although the real impact of the latter fact remains to be seen, so far the initial concerns over Beijing's interference with Hong Kong's famously free markets have largely proved unfounded. Hong Kong ironically continues to be one of the world's most open economies.

China is bound by the terms of its agreement with Britain to preserve Hong Kong's economic system for at least fifty years after the handover. To make sense of this contract, and indeed to help abide by it, Deng Xiaoping left his successors with a guiding concept: "one country, two systems." There was nothing wrong, he felt, with the coexistence of two economic systems so long as they could be made to function well together. It was a logical extension of his pragmatic thinking on the subject of cats and mice. It also vividly displayed, in a country where ideological pronouncements continued to carry considerable weight, how far he had taken the ideology of the Communist Party from its Marxist roots.

Breaking with Conventions

Deng's trip to the Pearl River in 1992 had preserved the course of reform—and, so doing, secured the conditions for the "one country, two systems" experiment. Thereafter, in the run-up to the Hong Kong handover, Deng remained uncontested paramount leader, though he held no formal title. His health was failing rapidly. Yet he had prevailed. He had shifted the course of the Chinese Revolution away from ideology toward the more pragmatic objectives of wealth and power. He had led another long march—this time from communism and central planning toward a market economy. At the Central Party School in Beijing, familiar courses on Marxism, Leninism, and the history of the Communist Party of the Soviet Union gave way to courses on marketing, accounting, and international business.

Deng Xiaoping died early in 1997, at age ninety-three, half a year before the return of Hong Kong and the practical application of his theory of "one country, two systems." In his funeral oration, Chinese president Jiang Zemin traced Deng's career—the victories and the seemingly fatal setbacks from which he managed to recover. What Jiang called Deng's "three rises and three falls" encapsulated most of China's twentieth-century history. Yet Deng ultimately prevailed and launched China on its course of reform. As Jiang put it, Deng "broke with conventions." When he came to power, China was desperately poor: 60 percent of China's people lived on less than a dollar a day. Reform launched China on high growth. Between 1978 and 2000, China's foreign trade increased from $36 billion to $474 billion. Per capita income doubled between 1978 and 1987 and doubled again between 1987 and 1996—a rate almost unheard of in modern history. It took Britain sixty years to double its per capita income; the United States, fifty years. In instituting reforms with such effect, Deng did something that no one else in history has ever accomplished—he lifted upward of 300 million people out of poverty in just two decades.

Half a year after Deng's death, in September 1997, the Fifteenth Party Congress assembled in Beijing to reaffirm China's march to the market. In 1978, the Eleventh Party Congress, under Deng's tutelage, had taken on the question of agriculture. Two decades later, the Fifteenth, in Deng's shadow, took up the other half of the question—the state-owned sector. Its financial plight had become of overwhelming urgency. Although some of the companies were well managed and profitable, the overall sector was inefficient, loss-making, and inflexible. Nonperforming loans to these enterprises accounted for as much as 40 percent of the total loans by the state banks. But solutions were much tougher than in agriculture, in terms of both ideology and practice. To the older generation of leadership, the very word *privatization* was unacceptable, while the concept of the "iron rice bowl"—guaranteed work and sustenance for urban workers—was a basic principle. Moreover, decisive change would not only upset deeply entrenched interests but also threaten social tumult; for reform held out the specter of millions or tens of millions of unemployed workers. Shifting assets out of the state's hand also opened the door to corruption. Yet the system could not continue; the piling up of debt by the state sector posed a grave risk to the country's overall financial stability.

The party congress declared that most of these enterprises—as many as a hundred thousand—would be divorced from the state and operated on the principle of what is sometimes called *ming ying*—"people-owned companies." This is an ambiguous phrase that certainly could include ownership by shareholders. As China's president Jiang Zemin put it—with a very conscious lack of precision—in his report to the congress, "Public ownership can and should take multiple forms in its realization." The tools for reform would include merger, bankruptcy, and, as Jiang put it, "downsizing." Though less noticed, the congress also endorsed the expansion of direct elections from village level up to the larger townships.

In March 1998, the Ninth People's Congress named as premier China's new leading reformer, Zhu Rongji. An engineer by training and a student leader in revolutionary days, Zhu, like Deng, had fallen afoul of the Mao orthodoxy several times and had twice been banished to remote areas. Rehabilitated at the same time as Deng, he had climbed the ranks of the economic ministries before being drafted in 1987 to serve as mayor of Shanghai. Zhu was not eager to leave Beijing, and he accepted his new post with reluctance. In the four years in which he served as mayor, however, he displayed an unusual dynamism and drive. He built roads and bridges, rooted out corrupt officials, and presided over an investment and commercial boom that reshaped Shanghai. His accomplishments drew the attention of Deng Xiaoping, who brought him back to Beijing as vice-premier. By 1997, Zhu was the uncontested key technocrat in China's government, and foreign investors and markets applauded his elevation to the premiership.

Zhu called for the swift restructuring of the state-owned companies. "The role of government and enterprise," he said, had to be "urgently . . . separated." At an unprecedented press conference immediately after his appointment, he declared his commitment to reforms, "no matter what is waiting ahead," whether "land mines or an abyss." He quickly set out to reduce the size of government and move toward more market-oriented systems, whether in housing or in banking. The word *privatization* was still not used. Rather, the emphasis was on the "corporatization" of state-owned companies—making them more responsive to the imperatives of the marketplace and to competitive pressures. In order to speed change in overbuilt sectors like textiles, the government went so far as to pay companies a bounty for each machine retired.

Zhu also put back on the agenda an idea that had first been floated years earlier—that of China's membership in what was now the World Trade Organization (WTO). Not an enthusiastic supporter of membership in the beginning, Zhu, and many around him, had come to believe that it would create external pressure for further reform. The measures that had proven to be politically most difficult—reform of the state-owned enterprises and of the banking and finance sectors, changes in agricultural pricing and marketing, the lowering of tariffs and import quotas, the dismantling of export subsidies, implementation of rules-based trade policies—would all become more feasible once China's markets opened to foreign competition. With their survival at stake, domestic industries would be forced to become more competitive. And it could always be argued that the most unpopular reform measures—including the bankruptcy of inefficient state-owned enterprises and the painful layoffs of millions—had been dictated by the forces of global competition and not by the government's decisions.

China was somewhat insulated from the Asian financial crisis: The financial market and currency controls, although protecting a vastly inefficient banking sector, had helped shelter it from the worst. But China did not emerge from the crisis unscathed. The global turmoil affected its export markets, impeding growth. Overall, the biggest cost of the reform of state-owned companies was the loss of jobs. The rising unemployment highlighted the risks of shutting down state-owned firms and putting workers out of their jobs without a proper safety net. Protests forced the leadership to call for a slowdown in industrial restructuring. Rural unrest was also on the rise, due in part to an increasing urban-rural income gap. Throughout the difficult times Zhu Rongji continued lobbying domestically and abroad for WTO membership, which, he was now convinced, was a fulcrum on which the rest of the reform would pivot. After several halts, on November 15, 1999, China and the United States—overcoming argument and opposition—finally signed an accord that would lay the foundation for China's accession to the WTO. The support from the leadership underlined China's commitment to further integration into the global market. In November 2001, China formally became a member of the WTO. The impact on China is likely to be far-reaching.

China and the World Economy

In many ways, China's accession to the WTO is a confirmation of what has long become fact: China is already an inseparable part of the world economy. In the last ten years, its international trade has more than quadrupled, reaching $474 billion in 2000. China is the world's ninth-largest exporter. Together with Hong Kong, it takes in 70 percent of all foreign direct investment in the region. With a 1.3 billion population, it is home to the world's largest consumer base, whose purchasing power is rapidly increasing. In 1999, on a purchasing-power basis, China's gross national product was second only to that of the United States, and it is the only country in the world with a reasonable chance, at least as seen from the current perspective, of overtaking the American economy in size. China is increasingly being viewed as the engine of growth for the region, a source of prosperity for the rest of the East Asian countries, a destination for regional exports and a significant investor in the rest of Asia.

The interactions extend beyond the measurable. With 55,000 Chinese studying in American universities each year, there are already more American-educated Chinese in China than Soviet-educated. Many stay in the United States, building up powerful diasporas, such as the one in Silicon Valley. But many return to the mainland to establish their own businesses or work with established Chinese or international companies. Along with cash, they bring back management expertise, technological know-how, and a new way of thinking that is grounded in the rule of law, civil liberties, and free markets. The Internet, which has been spreading throughout China at an unprecedented rate, has firmly connected a growing number of its citizens with the outside world.

China Adapts

But how to adapt the massive country with a hugely diverse economy and population to the changes that WTO membership will entail? The tasks are very considerable. Overriding everything is the balance between economic and political change. The one political verity for Deng was the Communist Party. Flexibility was possible on everything save the monopoly role of the party; without it, chaos threatened. And yet, could party control survive in a society that has nurtured a thriving market and opened to the world?

Deng's successor, Jiang Zemin, has made his bid: China's Communist Party will once again try to reform itself and adapt to the changing world. Jiang pointed to the way in a concept revealed during his February 2000 trip to Guandong Province—a trip that the Chinese state media unanimously compared to Deng's *nanxun*. The concept, known as "three representations," stated that the Chinese Communist Party's goal was to "represent the development needs of China's advanced social productive forces, represent the onward direction of China's advanced culture, and represent the fundamental interests of the largest numbers of the Chinese people." To those fluent in the party's language, however, the point was as clear as it was momentous: China's Communist Party no longer viewed itself as simply the vanguard of the proletariat. In a bid to broaden its base—and thus retain its relevance in a rapidly changing society—it was extending its hand to the elements that until then it had officially shunned. Jiang made the message even more blunt on the party's anniversary the following year: after eight decades as a party of the workers and peasants, China's Communist Party was welcoming businessmen and women into its ranks.

This new ideological restructuring is particularly important at a time when China faces a sweeping leadership change. Over the next two years, more than half of the current Central Committee and Politburo is expected to depart. The people who will come in the current leadership's stead—the so-called "fourth generation" of leaders—will be younger, better versed in the ways of market economy and, importantly, not constrained by the fears of social and political liberalization instilled in the current leadership by the Tiananmen Square massacre. In the absence of revolutionary experience, the new leadership's legitimacy will increasingly depend on economic development. With the new ideological platform, the party has made another bid to forestall—and, with luck, avoid entirely—the political upheavals that Russia and Eastern Europe experienced at the time of their transition to the market.

Among those who have risen to prominence in recent years is Hu Jintao. Much like Jiang Zemin, Hu (currently chairman of the Central Military Commission and the state vice president) owes his rapid rise to the top to Deng Xiaoping. He was born in 1942 in Anhui province, which makes him one of the youngest among China's top leaders. He attended Qinghua University, where he is said to have been a member of the university's dance team and was even known to "occasionally dance solo at parties." He is known as the lover of the arts, with a special interest in movies, operas, and novels. Having majored in hydraulic engineering, he took part in the construction of two hydropower stations in the upper reaches of the Yellow River. In 1982, Hu was elected Secretary of the Communist Youth League—a relatively liberal wing of the Communist Party (a sign that the next generation of leaders is being recruited from more diverse backgrounds than the current one). In 1985, he was appointed Secretary of the Guizhou Provincial Party Committee. It was then that Deng noticed the young party cadre. Ever concerned with grooming successors when they were still young, Deng picked Hu to go prove himself as the party secretary in Tibet—a position that Hu, who suffers from altitude sickness, executed largely from Beijing. Hu is now seen as the front-runner to succeed Jiang.

The challenges facing this new generation of leaders will be no less sweeping than the ones that faced Deng and his successors. One of the largest and most urgent ones is the uneven nature of China's economic development. Regional income inequalities—particularly between the eastern seaboard with its special economic zones and the western provinces, where 90 percent of China's poor live—have long been a major cause of discontent. Per capita incomes range from $3,400 in Shanghai, which puts the city on par with Turkey and South Africa, to $280 in Guizhou—the level of Yemen and Bangladesh. Correcting this distortion has been defined by Zhu as "a systematic project and a long-term task." Beside the obvious benefit of a higher and more equitable standard of living across the broader spectrum of the population, the development of the western provinces is seen as key to expanding the domestic market, which in turn would lay a foundation for further, less export-dependent growth.

The tasks are many. China faces the problem of building up free-market institutions, instituting the rule of law, reforming the banking sector, and freeing up the money currently tied up in nonperforming loans to state-owned enterprises. China may have won the battle for the general opening to the world, but not all China's provinces are prepared to open up their local economies to foreign competition, and local industries to foreign ownership. Internal protectionism continues to create barriers; "imports" from other provinces are frequently either prohibitive or heavily taxed. Overcoming the resistance of the local officials and consolidating the fragmented domestic market is another task facing the current and future leadership.

But the foundations are already there. The state has long been getting out of the business of running the economy. The floodgates of entrepreneurship are now open. Even the People's Liberation Army did not remain immune to the fever that came to be known as *xiahai,* or "jumping into the sea": some units began setting up firing ranges where foreign tourists could fire automatic weapons for a fee, while others made money by running karaoke bars and massage parlors. By setting incentives for all sectors of society, from local governments to schools and theaters to engage in entrepreneurial activity, an exceptionally broad market base has been established. The result has been not only impressive but critical for China's growth. Between 1991 and 1997, the private sector's output grew by 71 percent, contributing nearly two thirds of China's GDP in 1998. By 1999, employment in the private sector was exceeding the combined total for all other sectors, making it crucial in absorbing the labor laid off from state-owned enterprises.

The retreat of the state is obvious in another aspect as well: it intervenes less and less in the private lives of its citizens. Although still authoritarian, China is no longer the totalitarian state it used to be. The mass rallies, the volunteer work, the collective parties, even the uniform way of dressing, with their underlying message of the submission of the individual to a collective will—all are fading into the past. The "hard work and plain living" dictum, with its emphasis on personal sacrifice and ascetic values, is gone. China's citizens are much freer to choose the lives and lifestyles that suit them. The exception is organized alternatives to the Communist Party, as represented in the Falun Gong spiritual movement. The public discourse created as a result of economic liberalization, the mass movement into the private sector, and the development of the Internet—all are beginning to influence the course of reform. The debate is not about whether or not China should continue liberalization. It is, rather, about the priorities, purposes, promises, and pitfalls of the reform. China is still far from being a democratic society, but the state's gradual retreat from the social sphere is creating an opening for the development of civil society—a crucial prerequisite for democracy.

The march begun by Deng more than two decades ago is far from over. His successors have to contend with circumstances that are much more complex. The deepening of reform will require tougher and politically less welcome measures. Until now, pragmatism has allowed China's communist leadership to join Mao's thought with Deng's theory and Marxism-Leninism with capitalism. But the combination of an increasingly fluid and dynamic market economy and a rigid, authoritarian political system is challenging. If economic restructuring continues and there is no disruption, the ceding of monopoly on power is likely to follow.

Economically, too, reform continues to produce controversy. Progress has been uneven; the country has moved through periods of boom, bust, and retrenchment. Corruption is a major issue. Some argue that by giving in to conservative pressures at home and allowing the reform to slow down, Zhu missed a crucial window of opportunity in reforming the state-owned enterprises. There is fear that, as a result, China's unreformed industrial giants have remained unprepared for foreign competition that WTO membership will bring and are facing a major shakeout, whose reverberations will be felt throughout the whole system. Already tens of millions of underemployed and unemployed people float between the countryside and the cities, without a suitable social net to rely upon. Major bankruptcies among the state-owned firms will affect the state-owned banks, which have been financing them, causing unemployment to surge even further. The financial system truly is greatly overextended. Environmental degradation threatens the health of millions of Chinese. (A major reason for the push toward natural gas is to relieve the high levels of urban air pollution.) Inflation periodically sweeps through the economy. Crime has become much more common. The new stock markets have engendered more than their share of panics, and in some cases riots. The central government and the provinces are in continuing confrontation. The divisions—between rich and poor, east and west, urban and rural, private firms and state-owned enterprises—create strains on the reform. Meanwhile, human rights issues are a source of tension between China and the United States, and trade disputes roil China's relationships with other nations.

All this is an inescapable part of reform. Yet without continuing reform, China cannot meet its great challenge of poverty. Adjusting to and balancing the issues will require flexibility and adaptability. But that is part of the lasting legacy that Deng left China for the twenty-first century.

By the 1990s, Deng had already been cast in many roles—revolutionary, soldier, Communist, statesman, reformer, patriarch. But a new one was soon to be added—businessman. A Shanghai newspaper reported the generally unknown fact that while the young Deng was in Paris becoming a Communist in the early 1920s, he had also opened a restaurant called the China Bean Curd Shop. He did this at the behest of none other than his "elder brother," Zhou Enlai, who had initiated him into the revolutionary underground. Here, too, Deng's organizational skills came into play. The bean curd was good, the restaurant was a success, and Deng expanded both his menu and his seating space. The moral was evident: One could be a Good Communist and a fervent nationalist, seeking to ensure a unified China the wealth and power it deserved, and at the same time be a good businessman, providing something of quality that people would actually want to buy. That melding, more or less, is just what Deng sought to accomplish during his two decades as China's paramount leader. Complex thought it may be, that is the course on which China remains at the beginning of the twenty-first century.[13]