

## **Globalization and Domestic Governance: Major Challenges Facing China**

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REFORMS, PARTICULARLY THE open-door policy, jump-started China's economic development in the late 1970s. The rapid economic expansion that has been sustained for almost two decades coincides with the globalization of manufacturing processes, the telecommunications transformation, and the internationalization of financial markets. To some extent, one can conclude that China's rise is a result of taking advantage of such global processes (Lardy 1992). That is, China has pursued a strategy assuming that economic development is based externally on integration with the international economy for technology, capital, and markets, and domestically on the introduction of the market and the development of a consumer society (White 1993; Dittmer 1994; Benewick and Wingrove 1995).

Opening to the outside world means China has involved itself in the process of globalization in an increasingly interconnected and interdependent world. Beyond question, the forces of globalization are growing in strength and penetrating deeply into societies throughout the world. Not only capital, goods, and technology are moving across national boundaries, but also people, information, ideas, popular culture, pollutants, and so forth. Some of the challenges facing countries are posed by new and powerful forces emanating from beyond national borders, and they are thus beyond the capacity of individual nation-states to directly control (see Geithner 1997). China is no exception as it joins the world community. Clearly, then, globalization renders increasingly complex the

challenges Chinese government and society face in seeking a sustainable balance between rapid socioeconomic development and effective governance.

However, globalization is not the same as homogenization. How the challenges confronting China are perceived, prioritized, and responded to are still deeply embedded in domestic politics (Goodman 1997). This paper therefore attempts to identify some major challenges China faces as it moves to a market economy and engages in the process of globalization, and to examine their implications for the effectiveness of China's domestic governance.

### REFORMS, THE OPEN-DOOR POLICY, AND ECONOMIC EXPANSION

We all are aware that the history of China from the 1950s to the 1970s was one of politics—mass campaigns, power struggles, and the waxing and waning of Communist Party organizational strength. Economics played a determinant role only when political action became so extreme that the economy was severely disrupted and, in the case of 1959–1961, widespread famine ensued. China's history since 1979, in contrast, has been dominated by economics. The decisions that unleashed the economic engine of growth were politically motivated, but after that, economics drove politics much more than the reverse (Perkins 1997).

Once Deng Xiaoping took the initiative to reform China's centrally controlled economy and open China to the outside world, the attraction of the international economy generated tremendous domestic economic and political momentum, and foreign investors tripped over one another to commit funds and show support. The underlying factors for growth are now well in place: a high savings rate and hence a high rate of capital accumulation; an entrepreneurial populace whose talents have been unleashed; a basically sound natural resource endowment; the magnetic pull of the dynamic East Asian region; a favorable international environment; and the contributions of Hong Kong, Taiwan, and many ethnic Chinese in Europe, North America, and Southeast Asia (see Shirk 1996; Funabashi, Oksenberg, and Weiss 1994).

The open-door policy and rural reforms instituted in the late 1970s and early 1980s jump-started the rural economy, which caused peasants' per capita income to more than double in the five years from 1979 to

1984. Urban and industrial growth took off in the mid-1980s. As a result, in only sixteen years China's nominal gross national product expanded by 16 times, from 362 billion yuan in 1979 to 5.73 trillion yuan in 1995 (approximately US\$700 billion).<sup>1</sup> Even after adjusting for inflation, China's GNP in 1995 was almost five times larger than that in 1978.<sup>2</sup> China's per capita consumption increased apace, from only 184 yuan in 1978 to 2,311 yuan in 1995. After adjusting for inflation, the increase from 1978 to 1995 was almost four times, slightly lagging the growth of GNP yet representing a tremendous increase in spending power. Moreover, this fast growth is expected to continue. Estimates by domestic Chinese researchers and international scholars indicate that China's annual growth will slow slightly to a still-swift average rate of 7–10 percent between the late 1990s and the year 2010.<sup>3</sup> Official government estimates predict that China's GNP will grow to 8.5 trillion yuan by the year 2000, a 48 percent increase over the 1995 figure. Then, China's GNP is predicted to double in the first decade of the next millennium, reaching 17 trillion yuan by the year 2010.<sup>4</sup>

One of the most profound features of China's reform period has been the extent to which the country has joined the world economy. To speed up growth, China has made great efforts to expand foreign trade and to attract foreign direct investment (see Lardy 1995; *China in the World Economy* 1994). Since 1978, the underlying focus of China's development strategy has moved from import substitution to active engagement in foreign trade as an engine of growth. In 1978, China was ranked thirty-second in world trade. In the 1978–1995 period, Chinese exports rose from US\$9.75 billion to US\$149 billion. By 1995, its two-way trade was worth US\$280.9 billion, and it was eleventh in the list of the world's top trading countries. Over the same period, a significant change took place in the structure of its exports. Before the reforms, some 54 percent of China's exports were primary products, and imports were strongly biased toward producer goods. By 1995, while imports were still mostly producer goods they also included a diverse range of consumer goods, and some 86 percent of exports were manufactured products. In addition, a set of policies ranging from the establishment of special economic zones to tax incentives have been adopted to attract foreign investment: By 1995, therefore, China had become one of the major destinations for international investment flows, with the annual foreign direct investment into China running at a rate of US\$37.8 billion. After adding in foreign loans, China had nearly US\$200 billion of foreign exchange each year with which to import foreign technology and equipment (Perkins 1997).

All of these developments tended to reinforce the changes taking place within China. The opening outward meant that trade began to influence the structure of domestic production and consumption, that border prices began to affect domestic choices, and that foreign investment promoted the growth of export manufacturing which made use of China's abundant labor. As a result, China's experience during the 1980s and 1990s tended to support the argument that openness to trade is a mechanism for achieving more rapid and efficient growth and better distribution of domestic resources (Krueger 1995). China's increasing participation in the world economy has become one of the most important factors in promoting both growth and economic restructuring. Such a linkage is thus an essential element in China's economic success and in showing the effectiveness of gradualism in reform (Findlay and Watson 1997).

### CHALLENGES OF DOMESTIC PROBLEMS AND UNCERTAINTIES

While China has made impressive progress in its participation in the world economy and in pushing forward domestic structural reforms, a number of fundamental social, economic, and political issues confront the Chinese polity that are, more or less, consequences of the reform and openness. Dealing with these issues is a great challenge to China's domestic governance. Moreover, uncertainties existing in the society have increased the volume of pressures on China's leaders to meet domestic challenges. But perhaps this is nothing new, as "[u]ncertainty is a permanent condition of modern China," as some China observers have noted:

For over a century, unexpected, major developments have taken both Chinese and the outside world by surprise. . . . Periods of upheaval and turmoil . . . repeatedly have prompted popular Western images of an ungovernable China in permanent chaos. But such images are soon stilled by a stable China in the throes of rapid development, as in the 1870s, the first decade of this century, the early 1930s, the 1950s, and the last decade. Each era of stability and growth has been heralded as the dawn of a "New China," which in turn evokes another set of popular images: an aroused dragon, the pragmatic and entrepreneurial Chinese, and the world belonging to China in the next century. . . . Yet, none of these promising beginnings has been sustained. (Funabashi, Oksenberg, and Weiss 1994, 2 and 13)

The key question is, then, whether this time China's promising development will be sustained. The answer very much depends on the extent to which China effectively meets the following major challenges.

Perhaps the most significant major challenge is to maintain the momentum of fast economic growth. As a result of the reforms, hundreds of millions of Chinese have been lifted above the poverty line and now enjoy standards of living almost inconceivable only a decade ago. Yet, rising expectations brought about by rapid growth have increased the severity of pressures on national and local governments to provide more jobs, housing, education, and other services. Consequently, leaders have no choice but to continue to develop the economy as quickly as possible. In this sense, the inevitable result of China's leaders making economic development the primary goal of national policy is that sustained economic growth is now a key element in maintaining the leadership's legitimacy.

One way to meet this challenge is further integration into the world economy. However, this in turn requires domestic efforts. For example, the lack of a comprehensive and consistent legal system has long been a problem impeding China's economic transactions with the outside world. Although China has actually adopted many of the necessary laws, the problem of enforcement remains. This situation not only facilitates the abuse of power but also inhibits the development of a well-regulated, predictable market economy. Signs already exist that China's leaders are likely to seek institutional remedies to the problems of corruption, nepotism, and the widespread and arbitrary abuse of power. Because economic development is the top priority, it is probably true that, as one scholar has pointed out, "if a tradition of law is to be built in China, it is likely to be built first in the economic sphere" (Perkins 1997, 159).

Another underlying problem hindering China's economic development and openness is the lack of modern financial and banking systems. Ever since the beginning of the reform, significant differences in view have existed among China's economic leadership over the role of government in guiding the economy. The financial reforms started in the mid-1980s have been characterized mainly by decentralization. The banking system, however, is still largely controlled by the government at various administrative levels. The decentralized financial system, but without an independent banking system, has been a major source of many problems seriously impeding China's move toward a genuine market economy. For example, the failure to allocate investment in accordance with central government priorities has on occasion created transport and energy

bottlenecks that have slowed economic growth. This decentralization of control over investment has significantly weakened the power of the central government in more than just economic terms. It is hoped that China's leaders will see from the recent financial crisis in East Asia the necessity of modernizing both the financial and the banking systems, because many problems similar to those of other East Asian countries are found in China.

Moreover, a massive land area and population have resulted in a China that is still poorly integrated. One significant problem is that there is not yet a single, unified Chinese market. Throughout its history, China has lacked a truly integrated national economy, transportation and communication facilities have been weak, and local and regional economies have been largely self-sufficient (Skinner 1985). While reforms are lifting the levels of national integration and interdependence to historical highs, strong local, provincial, and regional barriers still exist. For instance, provinces trade less with each other than they do with the international economy (Kumar 1994). Developing a unified national market is certainly an urgent task of further reforms but not one to be accomplished easily, as it is indeed more a political than an economic task.

A related problem is regionally imbalanced economic growth, with the coastal regions of south and east China growing much more quickly than central and western areas. The difference is significant even in highly aggregated statistics. While the average 1994 rural income in the eastern part of the country was 1,617 yuan, in the west rural income averaged only 856 yuan, or 53 percent of the eastern average (*Zhongguo jingji tongji nianjian* 1996). The problem of poverty is also an acute symptom of the overall problem of widening income gaps between the developed coastal regions and the poorer central regions. Although China has made tremendous progress in pulling its population out of poverty, in western China and other areas millions still lack adequate food, clothing, and housing.

This uneven distribution of wealth in turn has spurred another major problem: labor migration. Chinese farmers currently till almost all the cultivable acreage, which is being steadily reduced owing to industrialization, urbanization, and desertification. Because Chinese agriculture already is highly productive, an increase in per capita farm income can be secured only by reducing the number of farmers and thereby increasing per capita productivity. Although estimates vary, it is likely that as many as 100 million Chinese have moved from rural areas to the cities and the quickly developing coastal areas. This so-called "floating population" has created difficulties for the governments of the regions that receive such

migrants, not only in terms of dealing with employment, housing, education, and the like, but also of maintaining public safety and stability.

Reforming China's mostly inefficient and loss-ridden state-owned enterprises (SOEs) is an even more serious challenge. About one-third or more of the state enterprises are in serious financial trouble. Other state enterprises are technologically equipped to compete but are financially vulnerable because of weakness in the financial system as a whole and the accumulation of large unpaid bills. On the one hand, allowing poor performers to simply collapse and go out of business is not politically acceptable, while on the other getting these firms in a position to compete is a very complicated task. As a result, SOE reform emerged from the 15th Party Congress in 1997 as one of the nation's policy priorities (*Gaoju Deng Xiaoping* 1997).

Reforming SOEs not only will increase unemployment significantly, but also will demonstrate the inadequacy of China's current systems of social security and social welfare, thus making it a potential threat to social stability. Despite a vigorous family-planning program, China's population increased from 962 million to more than 1.2 billion people from 1978 to 1995.<sup>5</sup> Although China has achieved outstanding economic growth since 1980, the crushing pressures of continued economic development and poverty alleviation for one-fifth of the world's population have diluted China's large absolute economic gains. On the flip side, the success of population control since its institution in the 1970s is creating an aging population, which will again expose the inadequacies of China's social security and social welfare systems.

Aside from the above-mentioned economic and social challenges confronting China, another major challenge relates to modernization's effect on the norms and values of Chinese society. Industrialization, urbanization, and now the technological and information revolutions have forcefully pushed aside the spent Leninist ideology, which prevailed in the minds of both the Chinese elites and masses for more than three decades. In addition, wider exposure to the outside world has challenged traditional values, threatened individual and group identities, and in general weakened the social "glue." The negative consequences are painfully evident in increased crime, drug use, prostitution, child abuse, and other forms of antisocial behavior, accompanied by a general decline in moral standards. Many thoughtful Chinese assert that the country now suffers from a spiritual vacuum brought on by the materialism of the Deng era (see Li 1994; Lu 1997).

It is indeed a great challenge for China's leaders to develop and propagate a set of persuasive beliefs that can unify and motivate the populace, all the while managing the tensions between tradition and modernity. Although some encourage a revival of nationalism to fill the spiritual vacuum, others are turning to Confucian tradition. In any case, an unprecedented pragmatism characterizes many in the rising generation of leading intellectuals, who seem more interested in addressing the concrete issues of political and economic development.

The environment is also a major challenge facing China today. In the 1980s, a survey of 878 rivers found that over 80 percent were polluted to some extent, with more than 20 percent so contaminated that their waters could not even be used for irrigation (Smil 1996, 24). In 1993, 300 Chinese cities experienced water shortages, 100 of them acute (Brown et al. 1995, 118). The spread of urban development, soil loss, and other factors are destroying scarce agricultural land. In the cities, air pollution is damaging children's mental development and causing increasingly high rates of respiratory morbidity and mortality (Smil 1993, 117). The annual costs of pollution damage and environmental degradation are enormous, with estimates ranging from approximately 10 to 15 percent of China's GDP (Smil 1996, 2). Unfortunately, to slow the rate of deterioration, ensure water supplies, and reduce toxic emissions in China will require investments of tens of billions of dollars. Never in its long history has China's ecology been under such intense pressure. Environmental issues affect the welfare of all humankind, and China needs to join with the international community in addressing them.

## IMPLICATIONS AND CONCLUSIONS

Meeting the twin challenges of effectively addressing domestic problems and social uncertainties as well as maintaining swift economic growth is a daunting task. The extent to which the Chinese and their leaders meet the specific challenges identified above—and thus whether they achieve a balanced and sustainable development—will determine China's future. This has important implications not only for China but also for the entire world.

There is no question that external openness greatly affects internal processes; what is at issue is a government's failure to deal with domestic problems. As I argued in the beginning of this paper, how external



influences are perceived and how they are responded to primarily depend on domestic conditions, at least at this early stage of globalization.

In fact, much of the debate on China's future, inside as well as outside the country, has been stimulated by events elsewhere, particularly the collapse of communism in the former Soviet Union and Eastern Europe and the end of the cold war, as well as by the literature accompanying these events (Fukuyama 1992). Many see the economic rise of East and South-east Asia during the 1980s and 1990s as inherently a process of homogenization leading to liberal politics, characterized by greater rationalism, individualism, democracy, secularism, and concern for human rights, the environment, and the rule of law (Robison and Goodman 1996). A central concern in much of the literature on China's development in the 1990s is the extent to which interaction with the rest of the world and greater domestic freedom will create pressure for capitalism and democracy. (In fact, this is a concern shared by the Chinese Communist Party, which—echoing earlier twentieth-century notions about the need to import “Western forms” but to maintain the “Chinese essence”—has sought to welcome Western technology and economic advances while restricting the social and political impact of openness.) This central concern regarding China reflects a general expectation of convergence that assumes a causal link between the establishment of an open market economy and liberal democracy (Shinn 1996).

However, a recent study asserts that the hypothesis linking greater international interdependence and openness to domestic reform, freedom from political control, and the unfettered operation of market forces is not proven in China's experience. The study's author argues that apart from any other considerations, the application of nation-state perspectives to a continental system such as the People's Republic of China may well be misleading: size and scale significantly affect the dynamics of change in its political economy. He suggests that the likelihood of domestic reform to lead to increased external openness is greater than that of increased external openness to lead to domestic reform (Goodman 1997). That is, even though the impact of external openness has been mixed, domestic conditions, particularly the level of economic development, are the major determinants of the extent and nature of domestic social and political reform (see Shirk 1993; Funabashi, Oksenberg, and Weiss 1994). This argument is to some extent also shared by other scholars.

After all, with its own history and traditions China is a distinctive and complex civilization and its rise should naturally reflect this distinctiveness.

Its path will be shaped largely by internal forces and the choices of its leaders. As products of their culture, the leaders approach their tasks of rule with their own worldviews and understandings about human nature and the purpose of governance. As the outside world seeks to incorporate China into the emerging world order, it must be remembered that China's leaders will wish to shape that order to suit their interests and to govern their country in accordance with their vision (Funabashi, Oksenberg, and Weiss 1994). That is, China's integration into the world community will be a truly reciprocal process.

On the other hand, however, one must not understate the changes to the political sphere in China brought about by openness and marketization. In fact, measures to reform the political system—some timid, some bold—were launched as early as in the Deng era: the development of a legal system and independent judiciary, the granting to parliamentary bodies at various levels the power to monitor the behavior of bureaucrats, and greater freedom for the media allowing investigative journalists to report on abuses of power. Other positive trends are seen in areas where, for example, the government is less repressive, government control of society has weakened, and state control over information flows from outside has been reduced, which was inconceivable under the previous control mechanisms. In addition, China has actively worked to readjust or strengthen its internal policies in order to join international groups and agreements such as intellectual property rights accords, the WTO, and numerous environment-related treaties.

Meeting the rather daunting domestic challenges will require significant investments of political attention and economic resources, and will induce China's leaders to maintain cooperative international stances as long as those stances do not directly compromise China's interests. Despite the various uncertainties about China's future, one can safely conclude that given the sheer number of Chinese and their yearnings for a higher standard of living, China's leaders must pursue a development strategy that yields high economic growth rates. This imperative necessitates the continuation of China's opening to the outside world—for technology, equipment, capital, and markets—and the continuation of economic reform to increase efficiency and productivity. Moreover, national, provincial, and local bureaucracies and leaders have acquired significant vested interests in the policies pursued during the past 18 years. More fundamentally, even, is the fact that the regime's legitimacy is at stake. Any effort to reverse these policies would encounter significant resistance and come at considerable cost.

NOTES

1. Average per capita income was 160 yuan in 1979 and 355 yuan in 1984. Such statistics are readily available in annually published volumes such as the *Zhongguo jingji tongji nianjian* (China economic statistics yearbook), 1996.

2. According to the *China Economic Statistics Yearbook's* Index 1, if China's GNP is normalized to 100 in 1978, then the corresponding index value in 1995 is 489.2.

3. Two disparate estimates are found in Institute For International Studies (IIS), "China in the Year 2010," *Interactions*, fall 1996, pp. 7-9; and the *Zhonghua renmin gonghe guo guomin jingji he shehui fazhan jiu wu jihua he 2010 nian yuanjing mubiao gangyao* (Outline of the ninth five-year plan and the year 2010 prospects of national economic and social development), passed by the National People's Congress on March 17, 1996.

4. *Outline of the Ninth Five-Year Plan*, 1996.

5. This is due to a variety of factors, such as population momentum and permitting rural families to have more than one child. Statistics are from *Zhongguo renkou tongji nianjian* (China vital statistics yearbook), 1995.

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