INTRODUCTION

China’s Economic Reform and Opening at Forty
Past Accomplishments and Emerging Challenges

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In 2018, China marked the fortieth anniversary of its reform era and the beginning of Xi Jinping’s second five-year term as China’s top leader. Xi had begun his first term by identifying serious challenges that confronted the country after a generation of mostly highly successful reforms, and promising dramatic changes to ensure the continuation of economic progress. Xi sought to reframe the modernization effort that had been at the center of “reform and opening” as an agenda of “national rejuvenation” to realize the “China dream.”

When Xi delivered his key speeches at the national meetings that confirmed his continued leadership (as Chinese Communist Party general secretary at the Nineteenth Party Congress in October 2017 and as president at the Thirteenth National People’s Congress the following March), he both reiterated his commitment to a bold new round of reforms and articulated ambitious benchmarks for success in the coming decades. Xi moved beyond vague references to “rejuvenation,” the “China dream,” and the importance of making great progress in time for the twin centennials (of the CCP’s founding in 1921 and the PRC’s founding in 1949). He called for China to become a fully modernized, advanced society by 2035 and a country in the front rank of the world’s great powers measured by
economic development and military power by 2049.\(^2\) Xi’s implicit comparator was the United States, and he thus suggested that in terms of wealth and power China should expect to be a true peer of the United States on the world stage by mid-century. Publicly stating these goals encouraged expectations of the Chinese people about improvement in the quality of their lives and raised eyebrows abroad as many wondered whether China was announcing its intention to use its greater clout—rooted in its long run of economic success—to reshape a post–World War II international system, including its economic institutions and norms, that has reflected the preponderant position of the United States.

Although Xi’s pronouncements in 2012–2013 promised decisive action on China’s mounting economic and economics-related problems, the record during Xi’s first term was unspectacular, in part because China has encountered large and intractable obstacles. Much of the difficulty that the Xi-era agenda for economic reform has faced reflects the consequences of four decades of remarkable accomplishments under the policy of “reform and opening” (\textit{gaige kaifang}). In December 1978, China was barely two years into the post–Mao Zedong era. The chaos of the Cultural Revolution was still a fresh memory. The rural economy was based on collectivized farming, with mandatory sales of agricultural output to state procurement agencies. Urban industry and commerce were largely state-owned and subject to state economic planning (albeit in a less pervasive form than in Soviet-style economies). China’s per capita GDP was around $200 (in current U.S. dollar terms as measured by the World Bank), ranking it among the poorest countries in Asia and around the tenth percentile globally.\(^3\) China’s foreign economic policy was one of near-autarky. Exports were seen as merely a way to acquire foreign currency necessary to pay for imports, and trade was conducted through a handful of state monopoly companies. International trade was less than 10 percent of China’s GDP, and foreign investment was negligible.\(^4\)

All of this began to change in December 1978, with the Third Plenum of the Eleventh Central Committee of the Chinese Communist Party—the cumbersome name for the foundational moment of the reform era. The meeting marked the consolidation of power by Deng Xiaoping, who had returned from a second period of political oblivion following his purge at the instigation of the radical Gang of Four after the death of Deng’s sometime patron, Premier Zhou Enlai. Partly building on the Four Modernizations associated with Zhou and adopted by Mao’s short-lived successor
Hua Guofeng, Deng and his leadership cohort launched the policies of “reform” (meaning market-oriented economic reform at home) and “opening” (to economic—and broader—engagement with the outside world).

The first decades of reform brought striking results, largely due to a fundamental political choice to eliminate obstacles rooted in the planned economy and Mao-era policies, and to permit formerly prohibited activities that seemed sure to boost production and productivity by tapping into labor reserves, human capital, and entrepreneurial talent at home, and capital and technology from eager investors abroad. Mao had repeatedly rejected economic policies of this sort. He did so not because he did not think they would produce economic growth but because they did not align with his ideological preferences. Mao implicitly acknowledged as much when he temporarily tolerated partial returns to basic market economic principles to overcome difficulties his policies produced. In periods of retrenchment from collectivization during the middle 1950s and after the Cultural Revolution, but most spectacularly in the aftermath of the depression and famine the Great Leap Forward produced, Mao entrusted economic policy to pragmatists to find ways to promote an economic recovery. What worked in each instance was an embrace of market norms (especially relying on material incentives and responsibility for profits and losses) that became the kernel of the reform and opening program adopted at the end of 1978. Notably, when Deng led the break with the Maoist past, he echoed his own pragmatic approach to policy from the post–Great Leap retrenchment—one that had been anathema to Maoist economic policy: “It doesn't matter whether the cat is black or white; if it catches mice, it's a good cat.”

Once in charge, Deng and those around him permitted bottom-up initiatives that enlivened the domestic economy. The first big breakthrough and fundamental key to success was the decollectivization of agriculture, which amounted to a return to family farming under the production responsibility system. Although the land itself remained collectively owned, land use rights were allocated to individual households. Rising state procurement prices and free markets for the sale of agricultural products reconnected labor and investment with material rewards. The regime thus essentially followed a program of land reform that had fostered productive agriculture elsewhere—including in the PRC before collectivization in the 1950s.

Early in the reform era, the regime also began to tolerate small-scale
private entrepreneurs and altered the economic incentives for larger enterprises in the urban industrial and commercial sectors. Here, too, the logic of relying on material incentives, the relaxation of price controls, and the freeing of markets were defining features of reform policies. Enterprises gained new freedoms to choose suppliers, customers, and employees, often using contracts to structure those relationships and create legal rights and obligations.

Key policy changes for established enterprises included the granting of greater autonomy to managers and the assignment of responsibility for profits and losses to production units and their leaders. State-owned and collectively owned enterprises faced a hardening of the typically soft budget constraints of socialism that had undermined enterprise efficiency, and entered a more arm’s-length fiscal relationship with the state, which increasingly substituted tax payments for profit remissions and shifted access to capital from state allocations to bank loans, bonds, and other financial instruments. Especially as the reform era moved deep into its second decade, many state and collectively owned enterprises were privatized or at least corporatized. Such enterprises coexisted and competed with newer firms that always had faced more market-oriented incentives and constraints. These new enterprises took increasingly varied ownership forms, including single-owner private firms, limited liability companies, joint ventures, foreign-invested firms, and stock exchange–listed companies.

Reform in the urban industrial and commercial economy came later and proved to be more difficult than in rural China. There was no clear precedent in the PRC’s own history, or in the experience of other communist countries, for urban reform that was comparable to the template China’s initiatives on rural reform drew upon. The political clout of the bureaucratic patrons of state-owned industry, and more pointed ideological objections to dismantling the pillars of socialism in the industrial economy, slowed and diluted reforms. Success instead turned on “outgrowing” the inherited, planning-era economy with new sectors and types of firms emerging from below, and on the top-down decision to step up the opening of the country to the outside world.

The decision to end the self-imposed international isolation of Mao’s economic development model had, from the beginning of the reform era, envisioned a role for foreign economic engagement to boost the country’s modernization. At first, the regime was relatively cautious about encouraging trade and foreign investment, but the “opening” side of “reform and
opening” soon accelerated. Rights to engage in foreign trade were gradually extended to more numerous and diverse enterprises, and eventually were made universal. China began to lower its high tariffs and remove nontariff barriers, especially as Beijing intensified its push to enter the WTO in the 1990s, with its accession finally taking place in 2001.

Increasingly open and liberal rules for foreign investment developed over the course of the reform era. Geographically, foreign investment–friendly legal regimes began with four Special Economic Zones on the southeast coast at the dawn of the reform era, then expanded to more than a dozen coastal cities, to larger special zones, and even to far-inland areas (under the Jiang Zemin policy of the “great opening of the West”). A policy initiative for still-more-liberal enclaves began in 2013 with a free-trade zone in Shanghai. Policies and rules tested in such special zones often became models for nationwide changes.

Permissible forms of foreign investment proliferated and became more flexible over time. What began as a limited regime that allowed only for majority Chinese–owned joint ventures in 1979 expanded to include more flexible contractual joint ventures, wholly foreign–owned enterprises, a revised and more adaptable equity joint-venture form, companies that could sell shares to foreign individuals and, later, institutional foreign investors, and finally foreign acquisition of Chinese firms. Ever wider sectors of the Chinese economy were opened to foreign investment. Laws and policies shifted from requiring that projects generate foreign exchange or bring in needed technology, and that they receive probing case-by-case approval, to much more permissive rules that generally allowed foreign investment, except in a shrinking range of specifically prohibited sectors or cases where authorities determined that national security concerns (vaguely and broadly defined) weighed decisively against allowing foreign ownership.

These developments reflected an early and growing recognition of the benefits to China and investors of combining foreign capital and technology with China’s plentiful, able, comparatively docile—and, in the early decades, inexpensive—labor supply. From the beginning of the reform era through the dramatic impact of China’s accession to the WTO, foreign investment has been closely bound up with China’s burgeoning export sector—which was also assisted by currency policies that gave Chinese goods an enhanced price advantage in global markets.

For China’s leaders and policy-makers, the international opening also served to advance domestic reform. They recognized the usefulness of in-
ternational competition in catalyzing change. The torturous negotiations that led to China’s WTO entry at the turn of the century provided leverage to push through policy reforms to improve the efficiency of domestic industry and subjected Chinese firms operating within China and in international markets to the discipline of competition with formidable foreign rivals.

After forty years of interlinked reform at home and opening abroad, China has been profoundly transformed. It has the world’s second largest economy by GDP measures, and the largest by purchasing-power parity measures. Its per-capita GDP has reached nearly $9,000, placing China among the group of upper-middle-income countries. Agriculture has been decollectivized and commercialized and has shrunk to less than 8 percent of GDP (from nearly 30 percent at the start of the reform era) as the countryside has industrialized and the population has urbanized, with more than half of Chinese citizens now living in cities. Although the definitions of state-owned, collective, and private enterprises are murky and contested, private firms, including foreign-invested ones, now account for most of China’s economic output. China has become the world’s largest trading economy (with a trade to GDP ratio of 38 percent, down from a 2006 peak of nearly two-thirds), ranks among the top destinations for foreign investment, and has emerged as a significant and rapidly growing source of outbound foreign investment, which is slated to expand as Beijing implements its Belt and Road Initiative. China has assumed a much more prominent role in international economic regimes, taking the lead in founding the Asian Infrastructure Investment Bank (a multilateral development bank) and promoting the Regional Comprehensive Economic Partnership (a mega-regional trade-plus pact), casting itself as a principal proponent of economic globalization in a time of U.S. retreat, and seeking to make the renminbi a major international currency.

The improvement in the standard of living among the vast majority of China’s citizens during the era of reform and opening has contributed to high levels of support for the regime and its policies. Despite disagreements among researchers about the accuracy of public-opinion surveys measuring support for China’s government, there is consensus on the general portrait the data present: A clear majority of China’s people (often an overwhelming majority) express satisfaction with the regime’s policies, are optimistic about the direction of the country, and indicate that they expect their children to have a better life than they do. In recent years,
the regime has moved more forcefully to address some of the problems that have been sources of significant public discontent, through policies that aim to improve the social safety net, tackle the environmental costs of focusing solely on rapid economic expansion, and reduce corruption.

Notwithstanding this impressive record, the regime also has faced mounting challenges in sustaining the economic success that has legitimated its rule. Although GDP growth was very high over the first decades of reform, averaging near double-digits, more recently the pace has slowed. In China’s larger and more mature economy during the 2010s, the leaders in Beijing have acknowledged this reality and adjusted the goals for GDP growth rates to a “new normal” of 6 percent to 7 percent annually. ¹⁰

Structural issues and deep-seated problems make the challenge of sustaining growth and economic transformation more daunting as the reform era enters its fifth decade. While the accomplishments of the first four decades of reform have been remarkable by any measure, the gains reaped during this period (and especially its early phases) were relatively low-hanging fruit. With much progress already achieved by abandoning Mao-era policies, following a fairly clear path toward initial market-oriented reforms, and exploiting China’s existing comparative advantage in engaging with the international economy, the tasks of reform have become more complex and difficult. China’s economic success since 1978 has brought it to a level of per-capita income that, in many developing countries, has been associated with a “middle-income trap”—that is, a stagnation of growth rates and a stalling out of hitherto rapid progress.¹¹

Rapid growth has been accompanied by severe environmental degradation, and China increasingly must bear the deferred costs of cleaning up its air, water, and soil, and the public-health consequences of not having done so. Demographic trends compound the difficulties: China faces the flattening of the Lewis curve as the relatively easy productivity gains of moving a vast agrarian population into the monetized industrial (and post-industrial) economy are exhausted.¹² Partly thanks to the restrictive population-control policies in place from the mid-1980s through the mid-2010s, China is confronting the waning of what had been a huge demographic dividend, with a rapid transition from a ratio of the old and very young to working-age population that was abnormally low by international standards to one that will be unusually high for a middle-income country.

In rural China, increases in agricultural production and incomes had already slowed by the mid-1980s, although the negative effects were offset in
part by a boom in “township and village enterprises,” which accounted for a growing fraction of rural residents’ incomes. But the TVEs themselves soon ran into serious financial difficulties, and shut down or were sold off in large numbers. Meanwhile, the movement of hundreds of millions of Chinese to cities, which was a major factor in national economic growth and transformation, stripped parts of the countryside of young, productive agricultural workers. By the 2000s, rural China, especially areas near fast-growing cities, faced additional stresses rooted in broader economic development as local officials seized and transferred land from rights-holding rural residents for meager—and often legally inadequate—compensation.

In urban areas as well, economic problems became difficult and complex. State-owned enterprises, which remained a significant factor in the economy, especially as sources of jobs and recipients of capital, continued to exhibit the productivity problems that made them a perennial target of policies seeking to advance still-incomplete reforms. Mechanisms for allocating capital were a source and a reflection of problems as well: stock markets have been notoriously volatile and occasionally crisis-prone; non-performing loans, partly the product of politically influenced or policy-driven lending to state-linked enterprises or local governments, have burdened China’s banks and required government measures to recapitalize them; and large, unmet demand for capital has led to the rise of extensive shadow banking and informal, sometimes illegal, lending practices that could pose systemic risks. Like their rural cousins, city dwellers have faced undercompensated expropriation of their residences and businesses by local governments acting in collaboration with real-estate developers.

Moreover, while overall incomes in both urban and rural China have risen dramatically during the reform era, the distribution of wealth has become more skewed. Wide disparities have emerged between prosperous coastal regions and a lagging interior, between cities and the countryside, and within urban areas that are home to the world’s first or second largest group of billionaires as well as recent migrants from the countryside who work in the informal economy and lack full access to China’s modest social safety net and other publicly provided goods.

Although the CCP regime has enjoyed, and enforced, remarkable social and political stability, it faces significant and likely growing challenges in these areas. The incomplete nature of economic reform in a one-party state where officials are not reliably held accountable for unlawful activities has made corruption an endemic condition. Officials and the politically con-
nected have engaged in arbitrage between state-controlled assets and new opportunities for enrichment that markets have presented. Public anger directed at local officials who may be blamed for various forms of corruption, environmental disasters, economic difficulties, abuses of power to expropriate property, and failures to deliver government services has produced tens of thousands of mass protests annually. Slowing growth, increasing inequality, and perceived unfairness in the distribution of opportunity mean that the regime faces a persistent risk of more significant, economically disruptive upheaval.

At the same time, China’s policy of opening to the outside world has been fading as a driver of growth and development. China’s international economic engagement expanded dramatically and did much to build China’s wealth and power during the first decades of the reform era. But by the twenty-first century, troubles were brewing. For an economy as large as China’s, export-led growth was no longer a realistic option. Foreign markets that had helped drive China’s growth during the first decades of reform were a limited and potentially unreliable source of demand, as became painfully clear with the global financial crisis of 2007–2008 and as China’s exporting prowess began to produce a backlash from its trading partners.

Countries and companies that saw their market shares or profitability falling, their industries relocating (many to China), their workers losing jobs, and their trade deficits with China swelling increasingly asserted that China was winning unfairly. China’s trading partners complained of tariff and nontariff barriers that limited access to China’s markets and impeded competition with local firms as China’s domestic consumption expanded. They also charged that Beijing improperly aided exporters, enabling them to sell their goods at below-market prices abroad, and that China manipulated exchange rates, keeping the renminbi’s value artificially low to advantage Chinese goods in foreign markets. As the reform era neared its fortieth anniversary, concerns about China’s industrial policies—especially the Made in China 2025 program and other efforts to move China to the global forefront of emerging, technology-intensive sectors—became a focus of urgent foreign worry and ire about Chinese policies that affect other states’ economies and the global economy. Bright spots for China’s trading partners—including high commodity prices driven by China’s booming imports—were not enough to offset these growing sources of friction.
China’s trade-related issues became salient in the electoral politics of major trading partners, especially the United States. Although trade liberalization had a generally positive effect on U.S. employment (especially in high-skilled service sectors), prices for consumers and intermediate goods users and overall growth, the lowering of barriers to Chinese goods and the resulting surge in imports from China did have a significant negative impact on jobs and wages in some manufacturing sectors and the localities where they are concentrated. Those unevenly distributed economic losses had political consequences. In the 2016 presidential election, candidates critical of liberal trading regimes, especially with China, fared well in primaries, with Donald Trump winning the Republican nomination and Bernie Sanders finishing a strong second to Hillary Clinton in the Democratic contest. In the general election, both major-party candidates condemned the Trans-Pacific Partnership—a sweeping trade-plus agreement with countries that had a less negative reputation among the U.S. public than China did. Assessments of the impact on voting of high exposure to Chinese import competition variously found that it drove support for more right-leaning Republican and left-leaning Democratic candidates, candidates opposed to trade liberalization, and Trump.

Although China has remained a top-tier recipient of foreign capital throughout the reform era, foreign investors have had chronic and, in some respects, worsening grievances about China’s policies and behavior. International companies doing business in China have consistently and stridently complained of a tilted playing field that benefits Chinese competitors at their expense through a variety of mechanisms that include selective and uneven enforcement of laws and regulations, favoritism toward well-connected Chinese firms, and preferential treatment obtained through corruption that multinational firms must forego because of home-country legal requirements, internal corporate rules, or concerns about public image and shareholder reaction.

In recent years, more charges have been added to the mix. Foreign acquirers of Chinese firms have been thwarted by China’s anti-monopoly regulators, in what frustrated would-be buyers see as instances of protectionism. The advent of broad authority for national security review of foreign investments has raised the prospect of additional forms of disguised protectionism. While weak protection of foreigners’ intellectual property rights has been a major focus of criticism throughout the reform era, in recent years E.U. and U.S. companies, and government agencies that hear
their complaints, increasingly have asserted that Beijing is leveraging foreign companies’ interest in access to Chinese markets to require sharing or transferring of technology and intellectual property, or simply stealing it in the course of business operations. Espionage by allegedly state-linked actors targeting United States and other foreign companies’ valuable commercial information and technology exacerbated this area of friction in China’s external economic relations.

Additional concerns emerging in the mid-2000s included the impact on national security of rising Chinese investment in significant or sensitive sectors of other countries’ economies. The response has been tougher laws, regulations, and practices that expand and tighten the process of oversight to limit Chinese investment in or acquisition of companies whose location near sensitive government or military installations, role in the domestic economy or defense industries, or advanced technologies might have implications for national security.20

After an election campaign that included much condemnation of China’s economic policies and their alleged effect on the United States, the Trump administration increased pressure on China and insisted that China accept demands that addressed a long-standing litany of U.S. complaints. With China not acquiescing to the U.S.’s agenda, Washington announced escalating and expanding tariffs on Chinese goods, and Beijing responded in kind. Under both presidents Obama and Trump, U.S. authorities indicted Chinese nationals accused of state-linked cyber-spying.

In U.S. policy discussions, the economic conflicts with China were one part of a larger dispute over a range of American grievances that linked political and economic concerns about China and that had been deepening for at least a decade. Major issues included state-sponsored cyber-attacks, the vulnerability inherent in relying on supply chains in which China played a central role, and the potential security risks of relying on Chinese technology in vital American infrastructure, especially telecommunications. The economic and related political and security issues contributed to a bipartisan reassessment of American policy toward China. The decades-long consensus on the wisdom of engagement, broadly understood—seeking areas of cooperation and managing conflicts with a rising China whose role could be shaped so that it would be a constructive participant in global affairs—had begun to erode during the Obama administration and declined further after Trump became president. In its place, a view of
China as a rising threat that had to be countered, and whose rise should not be facilitated, became the mainstream view in Washington.

Among American analysts and policy-makers, many argued that engagement had failed to deliver on its perceived and often-touted promises about the sort of international partner China would become. Some stressed disappointment that economic integration and growing prosperity had not led to liberalizing political reforms in China. Instead, after the 2008 Olympics and especially after Xi Jinping became the country's leader, critics noted the reassertion of authoritarian politics under tightened CCP control. Others focused on limitations to China's liberalization of the rules and practices governing foreign trade and investment despite promises undertaken when it joined the WTO in 2001. A minority continued to defend engagement. They acknowledged China's shortcomings and America's frustration with recent trends. But they argued that engagement had, in fact, served the chief and relatively modest purposes for which it was designed, and argued that it remained the only realistic way to provide incentives for China to become a more responsible actor integrated with an international community from which it might yet learn to appreciate the virtues of a more open society. Nevertheless, the critique of engagement prevailed, and it culminated in two key national security documents drafted by the Trump administration and was echoed in a high-profile speech by Vice President Pence. For the first time, U.S. national security strategy explicitly labeled China a “revisionist” power threatening the existing international order that has been favorable to American interests and called for the United States and its allies to adopt strong countermeasures.

In China, these accusations and demands struck a long-sensitive nerve. The CCP regime had emerged from upheavals and revolutions triggered by the bitter experience of encroachments and indignities inflicted by foreign powers that had oppressed and exploited a weak and poor China during the nineteenth and early twentieth centuries. The CCP regime's legitimacy derives not only from improving the people's living conditions—the preeminent metric for the post-1978 period. It rests also on fulfilling the long-standing aspiration of Chinese nationalists never again to fall prey to the bullying that characterized the “century of humiliation”—an agenda that has been gaining prominence under Xi, surely in part due to the mounting challenges of sustaining economic performance as a basis of legitimacy.

Facing a worsening external environment and significant domestic eco-
nomic challenges, how will a China that has become much richer and more influential since 1978 adapt and respond as the era of reform and opening moves into its fifth decade and as Xi prepares for a tenure that (after constitutional revisions abolishing term limits for president were adopted in March 2018) seems likely to extend beyond 2022? In some areas, ambitious economic reform goals have been set and work has begun.24

Yet, despite the fanfare accompanying pledges to deepen reform, in practice the Xi regime has mostly moved down a broadly familiar path. Xi has paid rhetorical respect to the Deng era’s agenda of “reform and opening.” He has extended the Hu-Wen leadership’s commitment to an economic-development strategy that emphasizes quality of growth (including sustainable development) rather than focusing only on GDP gains, relying on domestic consumer demand rather than exports or state-driven investment to fuel China’s growth engine, and addressing income inequality and reweaving a social safety net.25 Extending the broad arc of China’s reform-era development agenda, Xi has increased the salience of promoting higher technology and higher value-added sectors, and indigenous innovation. The goal is to make China’s companies internationally competitive—even dominant—in newly emerging industries (including telecommunications, biotechnology, artificial intelligence, and robotics), reprising reform-era China’s earlier success in becoming the factory to the world.26

At the same time, however, the Xi era has raised questions, both old and new, about the nature and trajectory of China’s economic reform and development. CCP ideology has begun to downplay the historical role of Deng—the avatar of China’s reform era—and emphasize Xi’s contributions.27 The potential for further reform faces constraints rooted in tensions among the key goals the regime set for the era of reform and opening: to make China more prosperous and more internationally influential while also ensuring the CCP remains in control. This multifold strategic agenda has always set limits to domestic reform and international openness. When the CCP leadership believes that economic changes threaten to bring political and social changes that jeopardize one-party rule, or, in the regime’s terminology, “unity and stability,” it opts for retrenchment.

Developments rooted in greater wealth, market economics, international openness, or technological advancement lead to inflation, unemployment, real-estate bubbles, stock-market crashes, unmanaged information flows, political dissent, social unrest, or vulnerability to foreign pressure, and prompt China’s leaders to prioritize countering threats to the party’s
control over reforming the economy and opening to the outside world. State intervention in markets, growing party presence in firms, slower progress or reversal of domestic economic reforms, and greater control over inbound and outbound international economic activity resurge, often at the cost of delaying what are recognized to be necessary reforms. Perhaps tellingly, the Xi regime’s most dramatic initiatives have centered on a wide and deep anti-corruption crackdown; a tightening in the ideological, political, and cultural spheres; a major reorganization of China’s military; and the launch of efforts (such as the Asian Infrastructure Investment Bank, the Belt and Road Initiative, and the Regional Comprehensive Economic Partnership) that may give China greater influence in shaping international economic rules, potentially in ways that entail lesser demands on China to assimilate to existing, market-oriented norms and rules.28

To be sure, a decisive turn away from the general direction of decades of reform and opening up may not occur. There may well be constraints that limit the regime’s political appetite for such moves. Because the regime seeks to maintain its leading position without relying solely on the coercive tools of authoritarian rule that are costly and perhaps, in the long run, ineffective, China’s leadership recurrently faces great pressure to relent on retrenchment and resume reform efforts that will improve economic performance and enhance legitimacy.

Nonetheless, the Xi Jinping era also has generated a distinctive set of uncertainties about the future of the reform era’s long march of gradual but progressive marketization of the economy and convergence with largely liberal international economic norms. Some see a formidable alternative “Chinese model” or Chinese-style state capitalist-model—one that can provide a template for developing countries and a rival to the neoliberal paradigm and the postwar international economic order.29 Others—including most of the authors in this volume—are more skeptical. From this perspective, the original reform-era development model may be running its course, and China’s leaders now face formidable, but not necessarily insurmountable, tasks that may demand that they innovate in ways that entail taking hitherto unacceptable political risks.30

The first part of this volume focuses on domestic economic reform. In an overview chapter, Barry Naughton characterizes the first three decades of the reform era as a period of “enlivening” the domestic economy. In his account, it encompassed several waves of rapid growth-supporting change. The
first waves came in the rural sector during the 1980s and early 1990s, with
decollectivization of agriculture and the grant of land-use rights to farming
households; followed by liberalization of the nonagricultural rural economy
and the rise of township and village enterprises producing labor-intensive
manufactured goods; followed, in turn, by opening the urban economy to
market reforms and the emergence of small-scale private entrepreneurial
businesses. The next wave enlivened the state sector, which had been the
core of the planned economy, but which faced massive layoffs and insol-
vency by the early 1990s. Here, key reforms included restructuring remain-
ing state-owned enterprises (SOEs) as corporations capable of surviving and
even thriving in a market economy. Primarily in the 2000s, the final waves
of enlivening arrived: massive migration of young, underemployed people
from the countryside to urban areas with more productive economies; privat-
tization of urban housing, which triggered a massive housing boom; and
China’s entry into the WTO, which brought a surge of export-led growth.

By the early years of the twenty-first century, Naughton argues, “en-
livening” gave way to “steerage.” Major market-oriented reform initiatives
ceased, notwithstanding ambitious but thus far unimplemented promises
for a new wave of reforms at the November 2013 Third Plenum of the
Central Committee elected at the Eighteenth CCP Congress, and the
persistence of old ways in many areas of the Chinese economy that would
benefit from further market-oriented changes. As the “miracle growth”
phase waned in a wealthier, maturing economy, and Chinese policy-
makers lost faith in enlivening, Chinese policy turned toward a new phase
of government activism to combat slowing growth in a largely marketized
economy. New development strategies focus on identifying and fund-
ing “drivers of growth”— principally, high-tech industrial sectors that
are strategic emerging industries, part of the innovation-driven develop-
ment strategy, or were covered by the Made in China 2025 plan—and,
secondarily, transport and communication infrastructure projects under
the Belt and Road Initiative. Naughton concludes that the model of the
Chinese economy that is emerging in this post-enlivenment era is a not-
yet-well-understood blend of interventionist and, in some respects, risky
state policy and reliance on innovative private—but, in some respects,
state-dependent—enterprises.

Economic reform began in the countryside. In Jean Oi’s account of
four decades of rural reform, initial successes and mounting difficulties
both stem from strategies of partial reform, permitting market-oriented
changes while not transgressing core principles of the socialist system. Oi assesses decollectivization without privatization of land ownership; rural industrialization without a fully private sector; and rural to urban migration while retaining the *hukou* system of household registration.

Decollectivization, which gave peasants rights to manage land and receive benefits from its productive use, and increased prices for agricultural outputs—from state procurement agencies and consumers’ newly freed markets—produced big gains in productivity and income. But decollectivization deprived local governments of revenue, which led them to impose heavy fees on rural households that generated unrest. This, in turn, prompted policies to recentralize control over local cadres and revenue collection in the 1990s and to reduce fees and taxes on peasants in the 2000s. In this context, the decision not to privatize land ownership brought unintended consequences: with land still owned by the collective, local authorities expropriated villagers’ land-use rights as a new source of revenue. Industrialization brought rapid growth to rural China in the 1990s, but collectively owned township and village enterprises (TVEs), along with private firms that worked closely with local officials, dominated. This pattern initially contributed to growth by ameliorating local officials’ opposition to the development of new enterprises. But support from the local state also meant lower barriers to enterprise creation, softer budget constraints, and weaker firms than would have been the case had rural industrialization relied on a true private sector. TVEs became a burden on local government finances and were privatized in a belated and disruptive transition. China’s retention of the *hukou* system, which in principle binds people to living where they are registered, initially fostered economic development, limiting what otherwise might have been the flood of urban migration that has vexed other developing countries, and giving rural authorities roles as labor brokers for peasants relocating to cities. But the *hukou* system also led to systematic discrimination against migrants, denying them access to urban public goods and leaving them vulnerable to forced repatriation. As *hukou*-linked rights to rural land became more valuable, former rural residents were unwilling to give up their *hukou*, which impeded reforms, including policies associated with the New Socialist Countryside. For Oi, all these areas reveal links between chronic problems of local government finance and the perils of partial reform.

Although reform in the rural economy was far from simple and varied across time and space, the story of reform in other sectors of the Chinese
China's Economic Reform and Opening at Forty

China’s economy has been more complex and fragmented. The two remaining chapters on domestic reform shift the focus to narrower, but illustrative, issues within the broad areas of urban enterprises and the financial sector.

Yasheng Huang tackles the question of changing patterns of ownership of enterprises in reform-era China. He takes as background the transformation of China’s industrial and service economy from state socialism and pervasive state ownership to the multiple and complicated forms of enterprises that legal and policy changes allowed during the first decades of reform, including: state-owned enterprises, limited liability companies, privately owned enterprises (including very large ones), stock exchange-listed corporations, foreign-invested enterprises, and others. Accounts of this dimension of China’s reform-era economic trajectory, including Nicholas Lardy’s *Markets Over Mao*, often stress the rise of the private sector and market-oriented enterprises relative to the state sector, relying primarily on output measures. Huang argues that such assessments overstate the change or ask the wrong question.

Huang analyzes the impact of policy on different enterprise types, focusing on changes under Hu Jintao and Xi Jinping—the period after the first waves of reform had created China’s complex landscape of firm ownership. He argues that output measures do a poor job of separating private (or non-SOE) enterprise gains due to efficiency from gains due to favorable policy, and that fixed-asset investment—which is heavily influenced by state policy—is a better measure of policy impact. Huang aligns varieties of capitalism (and socialism) with China’s categories of enterprise ownership: state socialism and SOEs; state capitalism and limited-liability companies (given the role of state financing and control in the types of enterprises often structured as LLCs); crony capitalism and privately owned enterprises (given the reliance of large private firms on political connections and the increasing reach of the party-state into private firms); entrepreneurial capitalism and foreign-invested, stock market-listed, and small-scale private enterprises (which are the types of firms least entangled with the party-state).

While noting limitations in Chinese data, Huang finds that fixed-asset investment data indicate that the Xi leadership has largely continued, but also accelerated, the Hu era’s “statization” of the economy and entrenchment of state capitalism. Huang also finds that crony capitalism has persisted (notwithstanding Xi’s anti-corruption drive). These patterns have come at the expense of state socialism and, a bit less clearly, entrepreneur-
ial capitalism. Under Xi, state capitalism also has evolved, reducing the state’s direct operating role in enterprises (which has been a hallmark of SOEs) while increasing state influence through providing funds and acquiring control over enterprises (in part through expanding roles of party committees, even in private enterprises).

Victor Shih turns to questions of finance, focusing on the trajectory of the corporate bond market as illustrative of the limits to financial sector reform. In Shih’s account, the development of bonds as a major component of a liberalized system of finance has been troubled since its inception in the 1980s. Political and policy concerns consistently have driven, and distorted, the development of bonds and bond markets, from a determination to avoid the instability associated with an inflation-driven panicked sell-off in the late 1980s, through reliance on bonds to finance costs associated with SOE reform in the 1990s, through dependence on bonds to fund priority policies during Zhu Rongji’s premiership in the 2000s, to the complicated challenges and policy responses of the mid-2010s that are the principal focus of Shih’s chapter. Shih discusses how potentially promising signs of the emergence of a corporate bond market in the early 2010s wilted as state policy returned to chronic habits of political intervention and used bonds to serve other policy goals. In this case, the policy uses of bonds were multiple and interactive: to provide liquidity in response to a crashing stock market and rising foreign exchange outflows; to address crushing local government debt (accumulated in pursuit of economically unsound projects and, in some cases, to sustain growth in the aftermath of the 2007–2008 global financial crisis) by converting debt owed to banks into bonds that banks were required to buy; and to recapitalize banks burdened with bad debt (partly as a result of lending to local governments).

In Shih’s assessment, the immediate consequences include a dangerous debt bubble (aggravated by nonbank financial institutions using problematic bonds as collateral for loans to buy more of the same) and the stifling of an economically healthy and reform-supporting corporate bond market. More fundamentally, the combination of the ability of the People’s Bank of China (PBOC—China’s central bank) to deploy massive financial resources and the broader regime habit of using bonds, and financial sector policy more generally, to serve policy ends and address immediate economic and political challenges, account for the weakness of reforms in this important area and the attendant costs and risks to the financial system.

The four chapters that compose the second part of this book exam-
China’s economic opening up to the outside world. This opening was initiated along with domestic reforms in 1978, but it later accelerated substantially to become a major feature of China’s economic rise in the twenty-first century.

David Dollar’s chapter provides an overview of this experience, as well as an evaluation of a perception that has grown more widespread among foreign analysts—that the world’s engagement with China, especially by the United States, has failed to achieve its purposes. At least in terms of China’s economic engagement, Dollar disagrees. Reviewing the evidence of the past four decades, Dollar concludes that engagement, though far from completely successful, has made substantial progress as intended along important dimensions—encouraging China to become more of a market economy, to integrate with the global economy, and to embrace international norms on trade and finance. Combining a summary of the historical trends with available data to measure performance, Dollar details changes in China’s policies and performance on trade, currency exchange rates and balance of payments issues, inbound foreign direct investment and related questions about forced technology transfer, outward direct investment from China including its culmination in the widely discussed Belt and Road Initiative, and the role China has played in major international economic institutions.

Having identified areas where engagement has proven beneficial for China and for others, as well as areas where China’s performance has fallen short of expectations or created new problems for others, Dollar concludes that the record is one that justifies labeling international economic engagement with China as mostly, although not entirely, successful. He also finds that this record justifies at least tempered optimism about the prospects for addressing remaining problems. Building on the successes of China’s international economic engagement will require additional reforms in China’s policies as well as reforms of the existing international economic order that should not be viewed as inherently unreasonable.

The remaining three chapters examine key aspects of China’s economic opening to the outside world. Yukon Huang analyzes China’s rise from irrelevance as a trading nation when the reforms were launched in 1978 to its current position as one of the world’s leading powers in trade. Like Dollar, Huang looks at domestic and international decisions that facilitated this remarkable achievement, as well as problems and tensions that success has generated—especially in China’s economic relations with the
United States and Europe. Drawing on a rich set of data, Huang sorts out the extent to which tensions over trade balances, investment, and technology reflect perceptions, as opposed to objective reality. He puts these tensions in perspective by comparing China with other Asian economies that have emerged as major traders. He shows that part of the story about growing tensions (especially over trade and investment restrictions, technology transfer, and intellectual property rights) is a familiar one and one that suggests the tensions will ease as a rising trading power—in this case, China—reaches higher income levels.

Still, and again like Dollar, Huang emphasizes that the current tensions are likely to persist and perhaps deepen unless both sides face up to the distinctive problems posed by China as a mixed economy, by China’s emergence as a security concern for major trading partners, and by new international economic worries about technology and information sectors that have emerged in the twenty-first century. Huang doubts that the World Trade Organization (WTO) will provide an adequate institutional venue for addressing problems that China’s economic emergence has generated. Reforms at the WTO may be helpful, but Huang suggests that a better approach to addressing the tensions between China and its trade partners would be for them to negotiate bilateral investment treaties.

Xiaojun Li examines China’s experience with inbound foreign direct investment (FDI). As noted in the other three chapters in this section, FDI played a major role in China’s remarkably rapid rise to global economic prominence. Inbound investment, beginning in 1979 and expanding greatly thereafter, was an important catalyst contributing to economic growth, enhancing productivity, and jump-starting international trade. Li’s chapter examines the data on FDI in China across sectors and regions, and the evolution of China’s regulatory environment for FDI. His discussion points to a decline in the share of foreign-invested enterprises (FIEs) in the economy as the number of private and large state-owned Chinese firms has surged along with overall economic growth. But, as Li also points out, even as the share of FIEs has declined, FDI continues to play a crucial role as a key driver of China’s international trade and as a source of tax revenues. Moreover, because the current leadership is determined to shift China to a path of sustainable growth that emphasizes the service sector and tapping the productivity benefits of innovative technologies, it is as important as ever that China remain an attractive destination for FDI.
Unfortunately, Li notes, the country’s leaders have thus far failed to address adequately foreign investors’ deepening dissatisfaction with the business environment they face in China. He underscores the need for Beijing to implement reforms that effectively answer investor concerns about fairness, predictability, and transparency. Nevertheless, like Dollar and Huang, Li sees grounds for tempered optimism that the current difficulties can be overcome. He also sees negotiating bilateral investment treaties as a plausible way to build a regulatory framework that will help deal with foreign investors’ concerns about market access and fair treatment while operating in China. Li also suggests that developments in China may make the prospects for progress on these issues brighter than in the past. Specifically, he emphasizes Xi Jinping’s increased political strength, which could enable him to overcome previously intractable resistance to needed changes, and the growing number of Chinese firms doing business abroad that want reciprocal protection for their own investments overseas.

Finally, Tom Miller’s chapter turns to one of the most dramatic features of China’s economic opening to the outside world, one largely unanticipated at the outset of the reform era—its rise as a source of foreign investment around the world. Miller contrasts China’s recently burgeoning outward direct investment with the first two decades of the reform era, when the story of China and foreign investment was overwhelmingly about capital flowing into China. In the early years, low production costs made China an attractive place for foreign investors to establish factories manufacturing goods for the global market and components for their transnational supply chains.

Miller highlights two steps that changed China’s role in international investment. First, at the very end of the twentieth century, Jiang Zemin proclaimed his “go-out” policy (zou chuqu), which called for a prospering China’s companies, at first mostly state-owned enterprises but a decade later joined by private firms, to go abroad in search of investment opportunities that would benefit China. The second step was the integration of this push for outbound direct investment with the bold strategic vision announced in 2013 by China’s new leader. As part of his call to rejuvenate the country and restore it to a position as one of the world’s most advanced, prosperous, and powerful states by the middle of the twenty-first century, Xi promoted an idea first dubbed “one belt, one road” (OBOR) but later termed the Belt and Road Initiative (BRI).

Miller describes the massive scale of this initiative, its expanding geo-
Graphic scope, its economic and political goals, and some of its early successes and failures. He emphasizes the dual purposes of China’s BRI—to facilitate connectivity through infrastructure development that can benefit China’s economy and the economies of recipient countries, and to nurture political ties and influence among states along the continental belt and maritime Silk Road that extends from China’s southern and western borders, across much of Asia and part of Africa, to Europe. In addition, Miller discusses the anxious reactions that BRI investments have triggered in some recipient countries and among observers who are concerned about the consequences of China’s distinctive approach to investment and development assistance.

Although the BRI has been underway only since 2013, Miller sees warning signs in the mounting problems and challenges that have arisen as the optimism at the time of its launch has given way to doubts about the economic viability of many of its projects, the resulting debt burdens incurred by recipients (and the related problem of possible “debt traps,” as foreshadowed by Sri Lanka’s transfer of a near-default port project to Chinese control), and the political resistance engendered in recipient countries, which worry that investments and outstanding loans will be translated into political leverage that undermines national sovereignty. The backlash that BRI-linked outbound investment is encountering leads Miller to a more pessimistic view about the future consequences of a rising China’s economic opening to the outside, and the possibility of managing the resulting frictions, than we see in the chapters that focus on trade, inbound investment, and other aspects of reform-era China’s external economic relations.

More than once, China’s economy has confronted fateful moments during the reform era—the political crisis that unfolded in spring 1989 and ensuing international opprobrium, the return to vigorous reform and opening following Deng Xiaoping’s southern tour in 1992, the reform of state-owned industry and the country’s accession to the WTO in 1998–2001, and the response to the 2007–2008 global financial crisis. Forty years into the reform era, China may have reached another fateful moment—one in which the regime could fundamentally rebalance and deepen reform in the domestic economy and recast China’s relations with the outside world. The fortieth anniversary of the seminal December 1978 party plenum coincided with long-emerging major challenges for China’s existing approach
and mounting difficulties in its external economic and related political relations—especially with the United States, where long-robust support for engagement has crumbled amid complaints about China’s international and domestic economic policies and practices and a growing sense of strategic rivalry.

The contributors to this volume cannot provide definitive answers about the paths the Chinese regime will choose or foretell the inevitably uncertain evolution of the circumstances in which China’s leaders will make those choices. But they do provide insights into the wide range of economic issues and daunting problems facing China. They also provide historical context by drawing lessons from the past four decades that should facilitate evaluation of the prospects for China and its economy as the reform era enters its fifth decade.

Notes


15. Martin King Whyte’s research has indicated that the fuel for such protests has not been growing socioeconomic inequality itself but rather the perception that connections rather than hard work enable some to succeed. Martin King Whyte, Myth of the Social Volcano: Perceptions of Inequality and Distributive Injustice in Contemporary China (Stanford, California: Stanford University Press, 2010).

16. See Pew Research Center, “Chinese Public Sees More Powerful Role in


20. In the United States, these concerns are addressed in large part through the Committee on Foreign Investment in the United States (CFIUS) process, which was amended to provide for more stringent review, largely in response to concerns about China, in 2018. See Jennifer Harris, “Writing New Rules for the U.S.-China Investment Relationship,” Council on Foreign Relations, December 2017; “Putting FIRRMA into Practice: What CFIUS Reform Means for Foreign Investment in the United States,” Center for Strategic and International Studies, September 25, 2018.


