

## Internal and external impetus for reform in China



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**L**es Miserable, the movie, could hardly touch a friend of mine from China. To him, the tragic beauty of a revolution is nothing new. Revolution has long been antiquated in China but it is still shown on TV over and over again. Since the commencement of the People's Republic of China in 1949, the Chinese people have not only achieved a revolution but also suffered from it. Today, instead of a revolution, the Chinese people are attracted by reforms that bring real changes to their lives.

There has been internal and external impetus for reform since 1978, the opening up of China to the outside world. Internal impetus for reform is the will of the leaders in the Chinese Communist Party (CCP) that aims to keep the seizure

of power. The leaders believe that economic development is the only way to achieve it. As put by Deng Xiaoping, *development is the absolute principle*. The leaders are keenly aware that anything but development, such as obsession to an ideology or empty slogans, cannot sustain CCP's power over China, a country with the largest population.

External impetus for reform, on the other hand, is the will of the outside world that attempts to gain benefits by approaching the Chinese market. China boasts of the largest potential market and massive manufacturing capacities but they yet to be fully assessed. Penetrating the Chinese market would surely lead to enormous profits.

At the beginning of reform and economic opening in 1978, the reform was carried forward through the opening. Those who initiated the reform did not propose the new reform agenda by themselves. Instead, they understood and responded to the agenda one by one, coming from the Special Economic Zones. At this stage, external impetus that brought the reform issues played an important role. The leaders of CCP were not sure about the reform and the opening. They first need to convince themselves of what was happening and what was about to happen; the reform was implemented incrementally. Had it not been for the support of the highest revolutionist leader Deng Xiaoping, reforms would not be realized. The reform at this stage was very fragile and often called "reform without losers", which means "making some better off without significantly harming any major group". (Berry Naughton, 2006, *Chinese Economy*, p. 91)

Ten years after its commencement, people's impatient expectation for reform and disappointment from it collided with the leaders' cautious approach, resulting in a three-year cooling off period of reform. Actions toward this socioeconomic and political restructuring resumed in 1992 with more determination and the 1990s witnessed strong modifications in full range. This period is often characterized as "reform with losers" because of the massive restructuring in the labor force of state-owned enterprises (SOEs). The internal impetus for reform proved itself rebounding from the three years' halt.

China's move to join the WTO in December 2001 turned the reform's initiation toward the outside world again. From 2001 to 2006, China successfully did the homework imposed by WTO. Tariff rate had been lowered and entry barriers in various industries had been reduced in compliance with the international laws.

After finishing the WTO process, Chinese reformers faced the challenge of standing alone and proposing the reform agenda by themselves. From this period, China took several measures for inclusive growth. Compared to the two previous stages, this reform initiative could be characterized as “reform including losers”. It was obvious that the largest group of “losers” had been farmers and migrant workers from the rural area. CCP’s 17th Third Plenum in October 2008 adopted The Decision on Driving Rural Reform and Development where a number of important measures were implemented for the vulnerable members of society, such as a more flexible residential registration system for migrant workers and granting disposal land usage right to farmers.

In 2011, the 12th Five-Year Plan (2011–2015) proclaimed that household income growth rate would be synchronized with the GDP growth rate, and minimum wages would grow by 13% annually; Social Insurance Law took effect in July 2011. These measures reflect the new agenda of transitioning from external dependence or fiscal investment to the one dependent on a healthy domestic demand from its massive population.

The most important policy announcement of the new leaders, including Xi Jinping and Li Keqiang, was the 18th Third Plenum’s The Decision on Major Issues Concerning Comprehensively Deepening Reforms in November 2013. The decision states that the market will play a decisive role in the whole economic system and care for vulnerable social groups will have better and wider coverage. In normal socioeconomic situations, market and inclusive growth cannot easily coexist with each other. The extension of market elements leads to efficiency while protection of minority groups is done not by market principle but by sharing values. In China, however, the two can coexist because China has yet to reach the Pareto optimality. In other words, both enlarging market’s role and protecting the vulnerable boil down to the process of rationalization or optimization, which can be sought simultaneously.

Regarding the recent Third Plenum, it is noteworthy that China has unexpectedly taken bold measures in the areas where external pressure to open the market has prevailed. In the financial area, it was promised that enlarging convertibility in capital account and marketization of interest rate and exchange rate will be implemented albeit slow progress. In the investment and service areas, negative system for FDI would be introduced and new agenda, such as environmental protection, investment protection, government procurement, and e-commerce, will be accepted in FTA negotiations. Those who had been skeptical about

the Chinese government's outlook toward these issues could hardly expect that these problems would be solved in this manner through the top leaders' declaration in the Third Plenum.

The reason for the Chinese leaders' open outlook on these issues might be raised in response to the external impetus to access the Chinese market. A more fundamental reason, however, originates in the internal impetus for reform because those measures will help growth transitions and in achieving inclusive growth. All the more, these reforms do not weaken CCP's ruling power. In spite of strong external impetus, there was no drastic reform on SOEs because it would hurt the Party's core interest.

In summary, although external impetus for reform played an important role in the period of initial opening and entry into the WTO, the underlying thrust was and will be the internal impetus. China's foreign partners, who proposed open and reform agenda whether in bilateral or multilateral frameworks, should understand the internal impetus in China before they submit anything. In some issues, they do not have to think of negotiating because China has its own schedule to introduce those agenda and policy. In others, however, they need to set a delicate strategy to make China persuade itself first. **KIEP**