



# CELEBRATING AN ECONOMIC TURN-AROUND

A look back at the events that have shaped China today

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Today China marks the 60th anniversary of the founding of the People's Republic. The celebrations, which have been under preparation for more than a year, rival those of the Beijing Olympics. The expense may seem lavish at a time when the rest of the world is just recovering from a financial crisis, but the fact is that China has a great deal to celebrate. Despite major challenges, China has evolved into the world's third most powerful economy. It is now the world's premier source for manufacturing and it is increasingly making its influence felt in shaping international affairs. Equally important, there is no longer any question of China turning back. Hu Jintao, China's president and the general secretary of the Chinese Communist Party's Central Committee, has made it clear to senior party officials that China's future is now firmly set on continued modernization and social stability.

How China achieved its present status is one of the remarkable stories of the late 20th century, and will undoubtedly have a major influence on the 21st century.

In 1949, Mao Zedong stood before First Plenary Session of the Chinese People's Political Consultative Conference and declared victory, announcing that: "The Chinese people have now stood up." This gave many Chinese people a sense of national pride following two decades of civil war and a succession of corrupt and ineffective regimes.

An even more critical factor was the fact that in 1949, China was largely agricultural, mired in poverty and lacked roads, bridges, railways, electric power and a communications infrastructure. Mao's first task was to move China's population (approximately 544 million) to a modern industrial-based economy. Despite a number of political and economic catastrophes, the plan ultimately worked, albeit at a cost. By 1979, China's industrial output, which had been only 12.6% of GDP in 1949, had increased 13 times to 46.8% of GDP. The size of China's rail network had more than doubled and the proportion of irrigated land had risen from 20 percent in 1952 to 50 percent in 1978.

Despite these advances, China still suffered from serious inaccuracies in its price structure, inflexible central planning, power shortages and inadequate transportation and communications networks. The next three decades changed that situation dramatically. China went from being the 19th largest economy in 1979 to the third largest today. Thirty years ago foreign currency reserves were practically non-existent. Today it stands at \$2 trillion.

How China reached this point is critical to understanding how China thinks today and where it plans to go in the future.

When Deng Xiaoping launched his Open Door policy to modernize China in 1979, the country was still suffering from serious imbalances, including shortages of technicians and other highly trained personnel, insufficient foreign exchange for procurement of advanced

technology and inadequate legal and administrative provisions for both foreign and domestic investment, among other problems. Its economic policies had until then favored state collectivism over private entrepreneurship. The ideology that had unified the leadership during the revolution had become a hindrance to modernization. There was a huge economic gap between China and developed countries. To modernize China a change was needed.

The turning point came during the third plenary session of the 11th CPC Central Committee meeting in Beijing in December 1978. A collective leadership of the CPC Central Committee with Deng Xiaoping at its core emerged from the meeting and a critical decision was made to turn away from chaotic class struggle and to focus instead on reconstructing China's economy. From that point on economic pragmatism would trump ideology.

Deng publicly explained China's new direction by observing: "It doesn't matter if a cat is black or white. If it catches the mouse it is a good cat." The transition to a somewhat de-centralized and entrepreneurial economy began in 1979 with the creation of four Special Economic Zones in Shenzhen, Zhuhai, Shantou and Xiamen. These would eventually provide skeptics with tangible proof of the effectiveness of a market economy. Deng called the idea "Crossing the river by feeling the stones."<sup>1</sup> A number of innovative approaches came from provincial leaders - often in contradiction with the rules laid down by the central government. Deng's contribution was to open the door to make experimentation possible. Reforms that succeeded spread quickly.

Deng followed up with agricultural reform in January 1982, which authorized farmers to sell surplus crops on the open market, resulting in a surge in agricultural production. A companion reform in 1984 authorized town and village enterprises to do the same. Price reform was carried out by establishing a dual track system with state subsidies reduced over an extended period of time.

The second stage of Deng's reform began in December 1986, with the phasing out of state-owned industry, a policy that popularly referred to as "Breaking the iron rice bowl". It was a difficult process. According to Chinese statistics, China's state-owned enterprises eliminated 15 million jobs by 1998, and then laid off another 30 million workers between 1998 and 2005. Sixty percent of China's workforce was forced to find alternative employment. By the time that

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<sup>1</sup> The expression had origins in a speech made by a senior party official, Chen Yun, in 1950, but Deng used it so often that it was eventually attributed to him.

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the 10-year transition had ended, China's industrial base had been fundamentally changed. Some form of state ownership stills exists in sectors such as financial services, energy, commodities and infrastructure. While the transition meant enormous pain for workers losing their jobs, it dramatically increased revenues, created a surge in productivity and unleashed China's entrepreneurial spirit.

The Tiananmen crackdown on June 4, 1989 frightened and alienated the international community. It raised questions about China's ultimate intentions. Growth dropped under 5% in 1989 and 1990, but Deng soon made it clear that he had no intention of deviating from the transition to a market economy. In early 1992, he traveled to southern China and declared: "To get rich is glorious." The statement signaled that more than ever China was open for business. Foreign investment began pouring in again.

China's next major step was to join the World Trade Organization in 2001. This forced China's newly privatized economy to meet international standards. Instead of holding China back, the WTO accession made Chinese companies vastly more attractive to international markets and far more competitive, while foreign companies could better access the Chinese market. China's growth has soared since then, helping it further become a world power that will play a major role in defining the 21st century.

Add all these major historical events together and what do you get? China's National Bureau of Statistics notes that the Chinese economy in 2008 is nearly 67 times larger than it was in 1979. According to the 2009 IMD World Competitiveness Yearbook, per capita GDP has gone from \$578.11 in 1995 to \$3,295.92 in 2008. Surely China has its many challenges ahead. But there is indeed a good reason to pause and celebrate these remarkable economic achievements.

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