

EC2374

Economy of Modern China

Semester I, 2010/2011

Sarah Y. Tong

Department of Economics

A brief review of lecture 3

Socialist experience

- A significant part of contemporary China
 - considerable economic and social achievement
 - but characterized as low efficiency and high cost
- Socialism was very appealing
 - historical experience and inspiration from USSR
- The economy was largely under central-planning
 - a big-push industrialization was forcefully pursued
 - industrialization was implemented through state ownership, party dominance, central planning
 - frequent policy changes lead to economic fluctuation
- Affected policy orientation in post-1978
 - a general consensus for reform
 - pragmatism in policy making

Topic 3 Reform & Transition

Overview:

- A gradualist approach
- Early “reform without losers” [1978-1991]
 - the initial breakthrough in agriculture
 - the main features
 - a general assessment
- Post-1992 “reform with losers” [1992-2001]
 - regulatory & administrative
 - outcome
- *Recent* “reform” efforts & challenges [2002-present]

Topic 3 Reform & Transition

A gradualist approach:

- Definition: gradual vs. big bang
 - pace
 - issue to tackle
 - extent of change
- Rationale
 - economic considerations
 - political calculations
 - objectives
- Feasibility
 - domestic conditions
 - external conditions





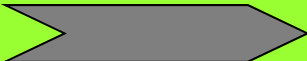
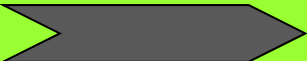


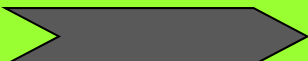

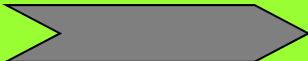
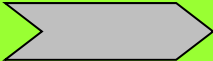
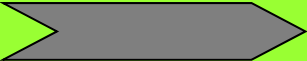

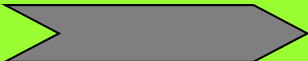


Topic 3 Reform & Transition

A gradualist approach:

- Characteristics
 - *reform without a blueprint*
 - institutional conservatism
- Advantages & disadvantages

Topic 3 Reform & Transition

A graduate approach:

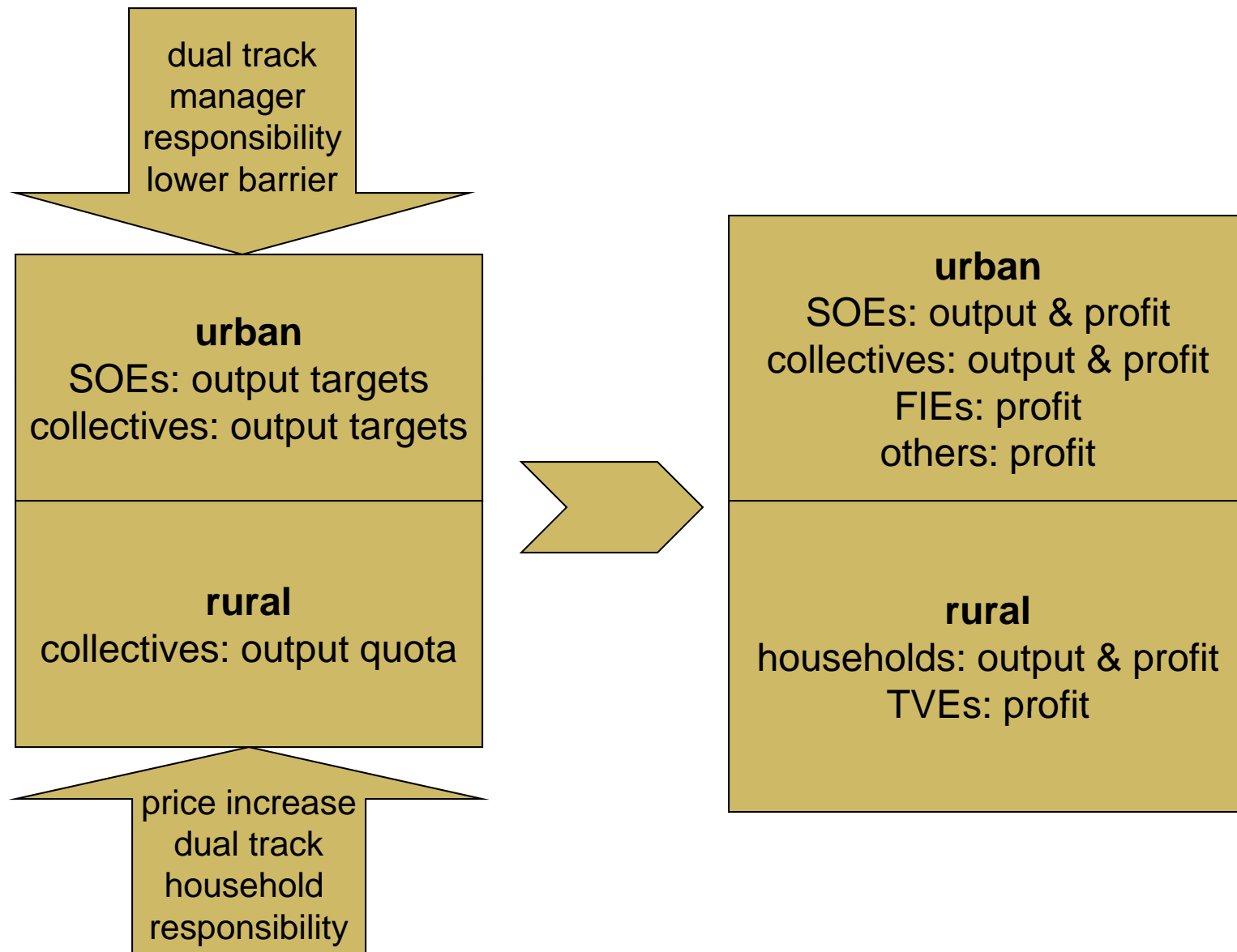
	early reform without losers	reforms with losers	recent reform efforts
<u>agriculture</u>			
<u>trade</u>			
<u>industry</u>			
<u>taxation</u>			
<u>banking</u>			
<u>financial</u>			
<u>welfare</u>			

Topic 3 Reform & Transition

Early “reform without losers”:

- Main features
 - to achieve economic benefits with little/minimum economic or social disruption
 - to stabilize the core of the economy while introduce incentives to economic players
 - to lower entry barriers & encourage market development
 - *growing out of the plan*

A demonstration



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Early “reform without losers”:

- The beginning
 - the 3rd Plenum of 11th Party Congress in December 1978
 - the Reversal of Cultural Revolution Verdicts
 - relative free and wide-ranging discussions
 - relax control on agriculture
 - the return of send-down youth, rightists, etc.
 - partly to maximize psychological impact

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Early “reform without losers”:

- Initial breakthrough in agriculture
 - reasons to start from agriculture
 - high degree of discontent with the status quo
 - relatively low level of uncertainty
 - small impact on sector under government controlled
 - losers: small in number, easy to identify & to compensate
 - greater payoff from success

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Early “reform without losers”:

- Initial breakthrough in agriculture

- bottom-up reform
- measures

Increase procurement price and above quota price

more autonomy to collectives

the spread of “Household Responsibility System”

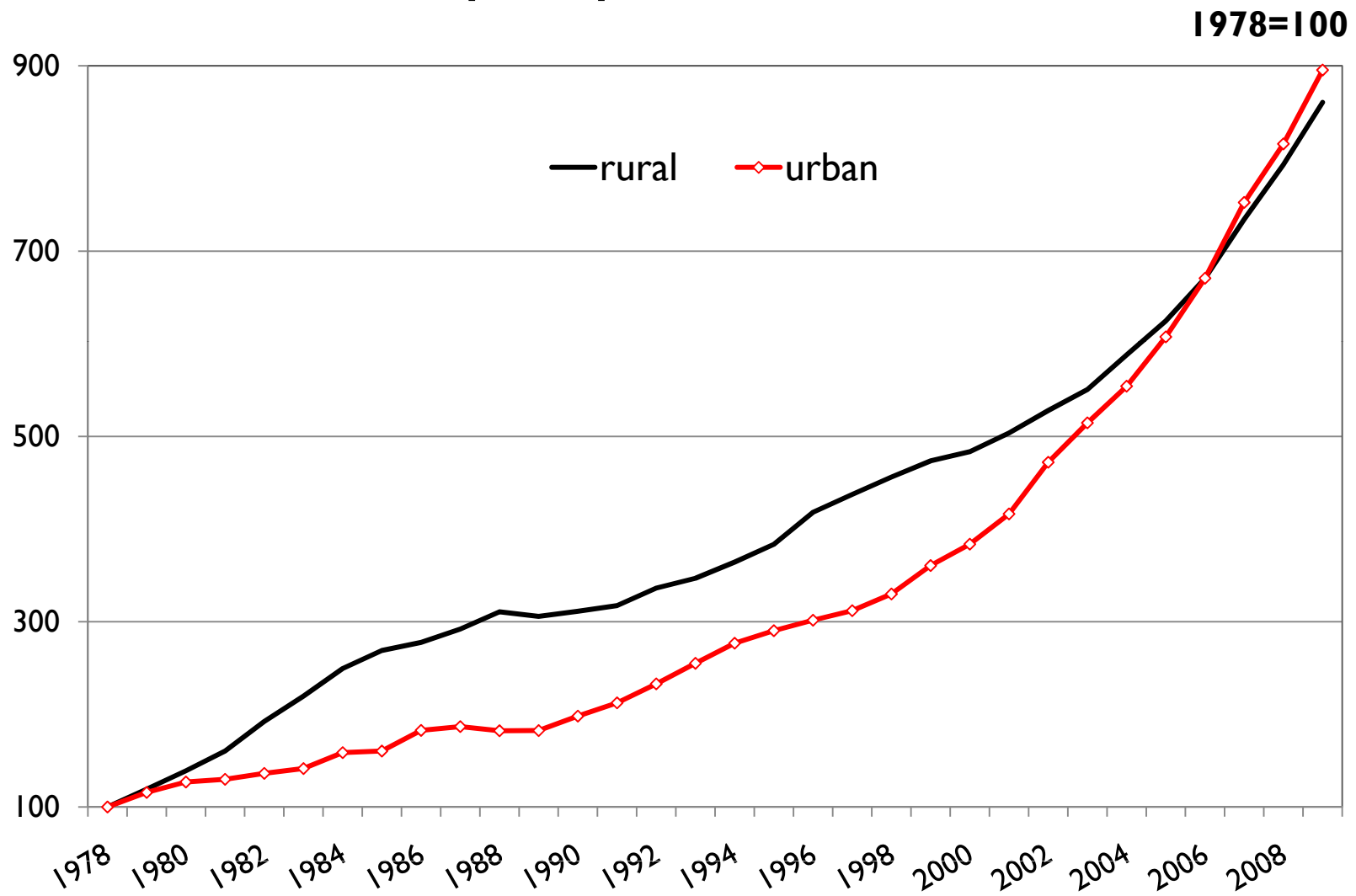
- results

strong incentives lead to rising productivity, & income

growing surplus labor (urbanization pressure)

the emergence of TVEs

Indices of per capita income, 1978-2008



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Early “reform without losers”:

- Strong incentives lead to quick results
 - dual track price system
 - coexistence of planned and market prices
 - agricultural as well as industrial goods
 - growing out of plan
 - fixed the size of the state sector in absolute term
 - non-state sector and non-planned activities grew
 - household/manager responsibility system
 - individual negotiations lead to particular contracts
 - tax payment, contributions to the planned products, etc.

Topic 3 Reform & Transition

Early “reform without losers”:

- State monopoly weakened through entry
 - reduce barriers
 - relax government monopoly in some industries
 - decentralization and local government participation
 - establish special economic zones
 - maintain macroeconomic stability
 - government planning
 - managerial reforms in the state sector
 - no privatization
 - autonomy and incentives of managers

Topic 3 Reform & Transition

Early “reform without losers”:

- Assessment

- *consistent & successful* only in retrospect
 - gradual market liberalization
 - market and competition
- ongoing policy shifts
 - two steps forward, one step back*
 - macro-economic cycles related to policy cycles
 - retrenchment in 1989-91: revive central-planning?
 - Deng’s Southern Tour in 1992

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Reform with losers:

- Main features

- establish & improve market institutions

the Decision on Issues related to the Establishment of a Socialist Market Economy (1993)

- rely on a unified market for resource allocation
- restructure the core of the economy
- create level playing field
- WTO membership & economic integration

Topic 3 Reform & Transition

Reform with losers:

- Prepare for the difficult reform
 - market reunification
 - abolish material balancing plan
 - contracts no longer applicable
 - recentralization
 - clarify the division of central local responsibilities
 - strengthen the Center's macro-management capacity
 - reverse the declining fiscal position
 - macroeconomic austerity
 - to control inflation
 - to harden SOEs' budget constraints

Topic 3 Reform & Transition

Reform with losers:

- Regulatory & administrative restructuring
 - fiscal & taxation reforms
 - to impose low but unified tax rate
 - central-local sharing of tax revenue
 - increase the center's share of taxes
 - banking and financial sector
 - establish a banking system similar to US fed reserve
 - central & regional banks: monetary policy
 - no more easy access to credit for SCBs
 - tackle non-performing loan problem (establish AMCs)

Topic 3 Reform & Transition

Reform with losers:

- Regulatory & administrative restructuring
 - SOE reform & corporate governance
 - Company Law of 1993*
 - SOEs reorganized as limited-liability corporations
 - stock listing of selected restructured SOEs
 - set up various regulatory bodies
 - external sector
 - exchange rate unified & currency devaluation (1993)
 - current account convertibility (1993)
 - WTO accession

Topic 3 Reform & Transition

Reform with losers:

- Outcome
 - continued growth
 - macroeconomic stability
 - low inflation since 1996
 - SOE restructuring & downsizing
 - increasing competition
 - hard budget constraint
 - ownership restructuring
 - shrinking role in the economy

Topic 3 Reform & Transition

Recent “reform” efforts:

- Remaining issues

- fiscal system

- central local relations

- financial sector

- financial sector still dominated by SCBs: NPLs remain a problem

- capital market under-developed: strong government influence

- industrial sector

- SOEs: weak corporate governance

- R&D for innovation and technological advancement

- agriculture sector

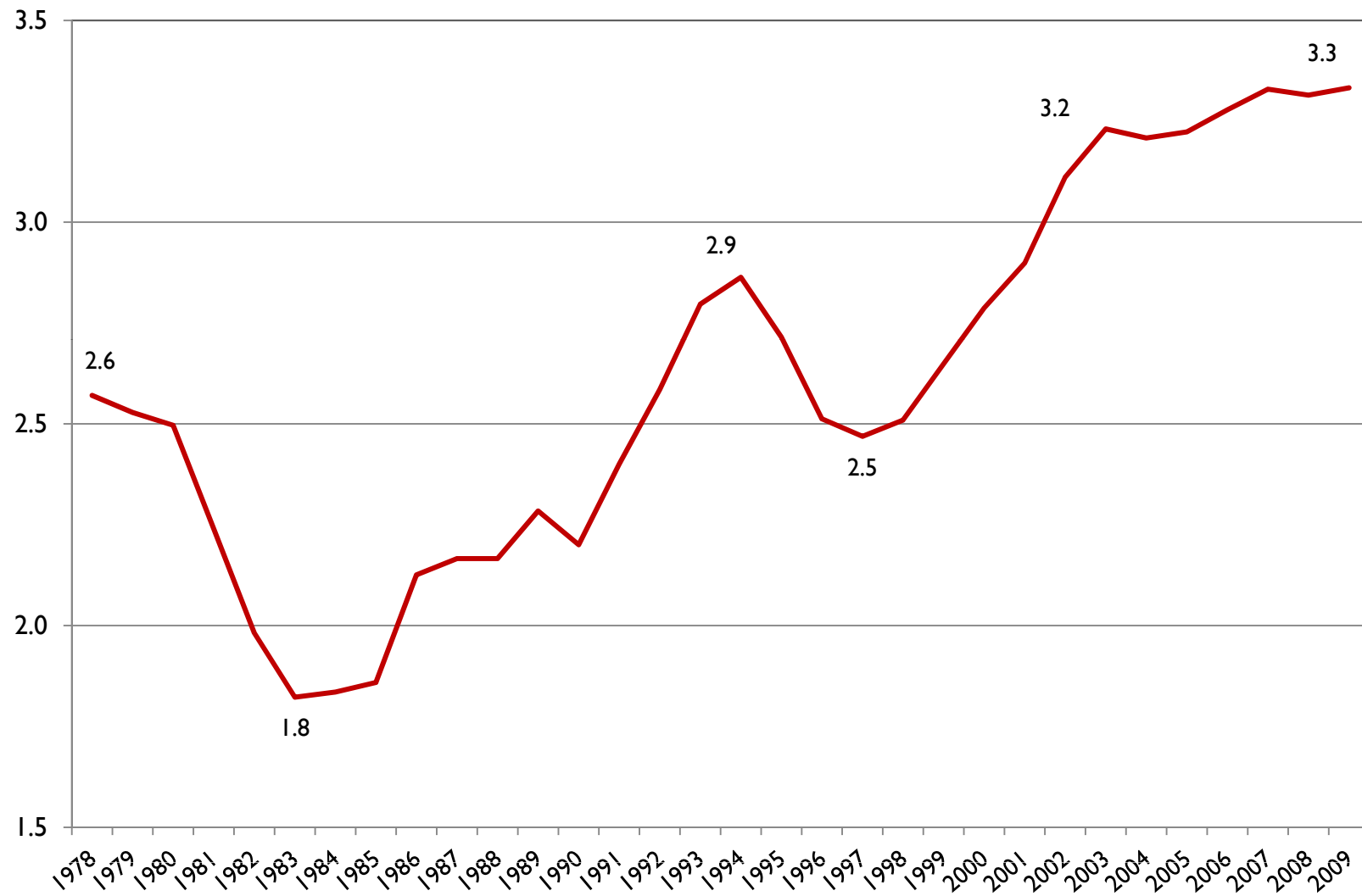
- difficulty to further improve productivity/income

Topic 3 Reform & Transition

Recent “reform” efforts:

- Emerging challenges
 - from recent/rapid development
 - income disparity
 - urbanization/employment pressure
 - rising imbalances
 - external imbalances
 - internal vs. external demand
 - investment vs. consumption
 - sustainability
 - environment / energy / resources

Ratio of urban to rural household income 1978-2009



Topic 3 Reform & Transition

Recent “reform” efforts:

- Few reforms

- fiscal system: limited change

- financial sector

problems of SCBs combined with local government borrowing
experimenting in capital market development

- industrial sector

SOEs monopolize in certain industries & crowding out non-state firms
R&D for innovation and technological advancement

- agriculture sector

difficulty to further improve productivity/income

Topic 3 Reform & Transition

Recent “reform” efforts:

- Much in social aspect
 - income disparity / urbanization pressure
 - social safety nets
 - regional development
 - socialist new countryside
 - accelerate urbanization

Topic 3 Reform & Transition

Recent “reform” efforts:

- Some efforts toward a more *balanced* approach
 - imbalances
 - reduce external imbalances
 - strengthen domestic consumption
 - sustainable development
 - industrial upgrading
 - stricter environmental regulations

Topic 3 Reform & Transition

Recent “reform” efforts:

- The impact of current crisis
 - fiscal stimulus package
 - “renewed” emphasis on investment & export
 - “renewed” emphasis on the role of government: industrial policy
 - the state marches while the non-state retreats (guo jin min tui)
 - some attempts to overhaul social safety-net