

## **From Transition to Development**

### **Introduction**

1. Struggling to emerge from poverty even in face of rapid growth
2. World Bank promotes China from lower income to middle lower income
3. Huge income disparity between extreme poverty to relative prosperity
4. Huge social disparity between household enterprises and business trained entrepreneurs
5. Diversity traced to 2 incomplete transitions
  1. Bureaucratic socialist to market economy
  2. Middle of a industrialization process

### **The Distance Traveled**

1. Introduced stability after a war torn period
2. GLF and Cultural Revolution destroys progress
3. CR destroys socialism
4. Slow but steady progress preferred
5. Transition has bore little large scale conflict or social costs unlike other countries
6. Many people move out of poverty

### **The Dual Transition**

1. China's challenges are increasingly similar to those middle income developing countries
2. Biggest challenge is the change in market ideologies but most of the transitional problems have been overcome
3. Focus is now on the challenges of development
  1. Need to invest in human and capital
  2. Need to protect under privileged
4. To overcome such problems, China needs to build stable, efficient institutions that can cope with social pressures
5. Socialist theme in 1950 adopted due to post war trauma and leaders believed it was the quickest way forward
  1. GLF and CR destroyed that
6. Market transition process yielded agricultural loopholes (and other amenities)
7. Material resources may have increased but economic instability has risen as well
  1. Urban dwellers facing unemployment
  2. Rural dwellers who migrate face similar anxieties

### **Chinas Growth Performance**

1. Growth is a result of unique historical confluence of 3 factors:
  1. Structural
    1. Healthy share of investment devoted to crucial infrastructure with public goods properties
    2. Also invested in higher human capital which complements socialist background of good health care and education
    3. Physical capital, labor and human capital all rising rapidly
  2. Transitional
    1. Benefiting from successful transition from socialism to free market economy
    2. Market = increasing competition = efficient
    3. Market = joining WTO
    4. Slow transition is key

5. Benefit from socialist foundations
3. Traditional
  1. Benefiting from a traditionally strong entrepreneurial society
  2. Globalization allows China to borrow technology to make use of its traditionally labor focused industries

### **Becoming A Normal Country**

1. Being big caused China to be isolated and had its own vocab and references for different economic issues, this caused it to be:
  1. An outlier in the past due to socialist institutions
  2. Outlier among socialist countries due to poor rural economy
2. Unique situations include:
  1. Low capital GDP but high proportion in the industry (over-industrialized)
  2. High life expectancy and literacy although poor
3. Things have normalized
  1. GDP, energy consumption and urbanization rates have normalized to that of other developing countries
4. Hallmarks
  1. Rapid and unusually persistent growth
  2. Extremely high investment rates
  3. Increased participation in world markets
5. Difficult to pigeonhole China as it is very much market like but still wrought with distortions from state ownership
6. Hard to analyze as China's government is quiet about its methods

### **China To The Future**

1. Challenges include
  1. Unable to correctly analyze and predict China. Most over or under estimate
  2. Inadequate human and physical capital
  3. Education and technological levels are low
  4. Needs more transportation and industrial infrastructure
  5. Institutions supporting high productivity economy are still new and very shaky
  6. Being huge means China finds it hard to push policies, only achieved minimum policy implementations in the past 25 years
    1. Some policies failed as well
    2. But enough to get past toughest obstacles
    3. China has to might to gather up resources to strike a specific issue if needed
    4. China also has a due degree of resilience
  7. China is expected to contribute to World welfare in the future with technological diffusions just like what Japan has done

## **The Geographical Setting**

### **Introduction**

1. Comparisons to US
  1. Only 2% larger
  2. Same latitudes = same climates
  3. China's land is more rugged and inhospitable (mountains, hills, high plateaus, west is full of deserts)
  4. Only 25% 500m above sea level compared to 60% North America and 80% Europe
  5. Low portion of arable land
  6. 1 coast only.
    1. South coast is rugged and hilly so harbors are cut off
    2. North is low and swampy also hard to build harbors
2. Results
  1. A more inward economy due to difficulty in trading.
    1. Only the southeast coast were more outward oriented
    2. Unable to have a strong seafaring trade like Japan and Europe
  2. Late start in economic modernization
  3. Now trying to target policies (Western Development Programme) on the desert areas

### **Landforms**

1. Tilts from west to east as Himalayas continues to grow
  1. Creates barriers for West - East transport
2. All rivers flow from west to east
3. West is high, arid and has very low population
  1. 6% lives west, 94% lives east
4. Generally a poor distribution of people over land. Some areas highly concentrated, some places very very sparse
5. Hilly land means low chances for cultivation
  1. Had to switch to labor intensive agriculture
  2. Highest grain yield per land area due to such dire necessity of land efficiency

### **Climate**

1. Wet summers and dry winters
2. Little rain or snow during winter as a high pressure zone causes steady flow of cold dry air over eastern China
3. Summer's low pressure area draws tropical maritime air to southeastern China
4. High rain in southern China as air hits cool mountain ridges
5. Inland basins however are very very hot (Chongqing, Wuhan, Changsha & Nanjing)
6. North is dry and south is lush. North often undergoes drought when monsoon fails to cross the central mountain belt
7. Desert in the west threatens to advance threatening population there
8. Yellow River - High dependence on 1 river by those living North
  1. Withdrawals take all available water and the river often runs dry
  2. Yellow river carries heavy load of mud and sand, deposits result in raised river bed = increased flooding
9. Yangtze River - Carries 20x water and only 1/3 sediments compared to YR and feeds lush South China
10. All these threaten environmental degradation in China. With increase in economic performance, stress on the environment would put China in constant environmental crisis for the next 50 years.

### **Provinces & Regions**

## 1. Regions & Diversity

1. 31 province level administrative units (all are ranked administratively)
  1. 22 provinces has official distinction
  2. 4 municipalities under national supervision
  3. 5 autonomous regions for ethnic minorities
2. Can also be sorted by macro regions (defined by rugged topography)
  1. *North China:*
    1. Plain is the largest flat land in China.
      1. Contains 25%+ of both agricultural land and population
      2. Contains Beijing, Tianjin
    2. Most important region to China
    3. Outside those 2 cities, mostly are rural with large villages
  2. *Lower Yangtze:*
    1. Contains Shanghai (most economically important city)
    2. 10% population, 21% GDP
    3. Higher incomes, higher urbanization rates
    4. Yangtze River Delta covers 50,000 km with dominant wet rice cultivation. Only 7% of China's arable land but produces 10% of total crop output
  3. *North East / Manchuria*
    1. Abundant natural resources - 9% population cultivates 17% of land.
    2. High coal, iron and petroleum reserves
    3. Heavy industries
    4. High agriculture mechanization produces beans for export
    5. But economic prosperity here is shrinking, no longer holds an important role in national planning. Lost out to North China
  4. *Sichuan (Chongqing + Chengdu) - Core of Upper Yangtze macroregion*
    1. No natural route into the basin.
    2. Fertile and densely populated
  5. *Southwest China*
    1. Usually lumped with Sichuan to form Greater Southwest China region
      1. Dense population but low income
      2. Ocean based trade when most of China was inward orientated
      3. Investment from Hong Kong and Taiwan has transformed the place
      4. Stopped during Maoist China but revived soon after.
  6. *Others*
    1. Entered reform but are lagging behind in development compared to coastal regions
    2. Land is small but will irrigated and intensively farmed. Exports to other parts of China.
    3. Major hub is Wuhan with trade and industrial roles extended outside the macroregion
3. Special Economic Zones (SEZs)
  1. Each targeted to a particular group of maritime Chinese as investment source
  2. Zones
    1. Shenzhen
      1. Setup next to Hong Kong to attract British investments
    2. Zhuhai
      1. Set up next to Macau to grab Portuguese investments
    3. Shantou
      1. Set up near Chaozhou to attract ethnic investments
      2. Especially important to SEA.
    4. Xiamen
      1. Set up to revive overseas links to south Fujian people. Grabs trading people from Taiwan
4. Others

1. Northern plateau region contains 10% population (Shanxi, Shaanxi, Inner Mongolia, Gansu & Ningxia)
2. Farms 18% arable land (poor quality)
3. Only accounts for 8% of crop output and 6% of industry
4. Vastly non-habited land

### **Mineral Resources**

1. Land scare but labor abundant
2. Mineral wealth is proportional to land area
3. Coal and petroleum industry is similar to world proportions
4. Rich deposits of tin, copper, tungsten and rare earth
5. Uneven distribution of mineral and energy sources
  1. North has 90% of oil, 80% of coal
  2. Southwest macroregion has high HEP potential
  3. South coastline has no resources - Needs labor and knowledge intensive path

## **Chapter 2: The Chinese Economy Before 1949**

### **Introduction**

1. Before 1949
  1. Traditional View
    1. Western pressure disintegrates China politically
    2. Economy failed
      1. Increased pressure from population growth
      2. No change in agricultural technology
      3. Risk of famine and disease
      4. Class division and extortion of rents from the poor
  2. Other View
    1. Some economist challenge that growth was slow but steady.
    2. Traditional Chinese economy well suited to support development
    3. Some government failure but long term growth has to be seen on a LR and there were good foundations in place
2. Changes after 1949
  1. Government mindset changes
  2. The start of rapid modern growth

### **The Traditional Economy (1127-1911)**

1. High Productivity Traditional Agriculture
  1. 90% rural
  2. Labor intensive agriculture
  3. Traditional but effective farming technology (Sophisticated irrigation, high yield seeds = 2x harvest, etc)
  4. High output per unit of land but low per unit of labor due to it being labor intensive
  5. Low incomes and consumption standards
  6. No use for animals, low protein intake for humans
  7. By 1800s, no more natural soil, all effectively man made
  8. New world groups aid farmer migration up slope
  9. Living standards stable till 1800 close to world averages
  10. Accounts for 1/3 of world GDP in 1820
2. Commercialized Countryside
  1. Thick network of markets tied together by inter-region water transport (via canals/rivers)
  2. Sophisticated Institutions
    1. Widespread use of money
    2. Familiar with large formal organizations (clans/lineage)
    3. Advanced commercial procedures with written contracts and obligations
    4. Legal standards in place with courts, law and order
    5. Traditional banks available for fund transfer nationwide
  3. Competitive Markets
    1. Coal, iron, textiles and tea
    2. Efficient markets for land and labor (factors of production)
    3. Substantial Factor mobility. No castes defined by birth
  4. Small scale bottom heavy economy
    1. Individual small scale households
    2. Handmade goods by families like textiles, leather goods and iron tools together with food products
    3. Households underwent vertical integration (silk)
    4. 1880 saw the rise of the tea industry supported by hundreds of tiny tea 'factories'.

1. Failed due to competition from Japan and India as household products do not have consistent standards
  2. Industry died in 1920
  5. Markets had easy entry and exits
  6. Low capital industries but labor intensive
3. Crisis of the Traditional Economy
  1. 1800s see severe limitations impending due to
    1. High population growth
    2. Lacking additional arable land
      1. Desperate farmers encroach on river banks prone to flooding. Ecology destroyed and famines result when floods occur
    3. Technologies exhausted
  2. Decline of Qing dynasty = failing public goods
  3. Poor taxation = low government revenues
  4. High income inequality. 1% of the population holds 20% of GDP
  5. Low MPL hurt small farms in north.
  6. High tenancy and low home ownership. Rents go crazy and hurt the poor
  7. 1860 southern China's Taiping Rebellion lasts a decade and destroys lower Yangtze Valley
  8. Long period of decline as Western and European powers began to rise
4. Failed Response to the West and Japan
  1. 19th century China in profound social crisis = easy prey
  2. Opium floods the Chinese market from British India causes shrinking supply of money metals (silver) + addiction
  3. China loses Opium War and cedes control of Hong Kong to Britain
  4. Loses 4 more wars and lost all of them. Had to pay for war damages and lost cities as well
  5. Japan begins to start encroaching China winning the Sino-Japanese war and control of Taiwan
    1. Japan's ease is caused by the Boxer rebellion and protocol
  6. Opening of China coincides with humiliation
  7. Foreign investment only concentrated on Treaty Ports. Shanghai is top treaty port. Political openings now a sensitive issue
  8. China's weakened government is key. Japan managed to stave off foreign intrusion with quick policies
  9. China descends to depths. Western impact is historically traumatic

## **Beginnings of Industrialization 1912-1937**

1. Summary
  1. 1911: Warlord domination, political fragmentation and civil war
  2. 1927: KMT unites China. Peace for 10 years. Seeds of future growth sown.
  3. 1937: Japan invades China
2. Industry
  1. Modern factory production grew 8-9% pre Japanese invasion.
  2. Treaty Port Industrialization
    1. Foreigners operate factories, Chinese follow suit (soon producing 78% of output value)
      1. Chinese gain experience with foreign contacts, skills spread rapidly. Those with most experience became cornerstone capitalists
    2. Output highly concentrated in treaty ports like Shanghai
      1. Focus on textiles as major export
  3. Manchurian Industrialization
    1. Sponsored by Japan to meet Japanese economic goals.

2. Development focused on heavy industries and railroads to exploit rich deposits of coal and iron.
  1. Huge steel mill and Anshan is still currently China's largest producer of steel
3. Not beneficial to Chinese
  1. Exports given to Japan's domestic markets
  2. Managers instructed to not subcontract to Chinese firms
  3. Machinery came from Japan
  4. Skilled positions only reserved for Japanese nationals
3. Breadth of Development
  1. Economists believe that 1920 to 1930 represents small but significant growth for modern sector
  2. Household sector grew slowly as hand weaved products were still preferred due to its warmth and durability
  3. Not much changed but vibrant foundations were laid for future development
  4. Human Capital
    1. 100,000 Chinese students went abroad to study
    2. 370,000 foreigners entered China.
      1. Exchange of skills and technology
      2. Stimulates intellectual and cultural growth

## **War and Civil War 1937-1949**

1. Summary
  1. Japanese attacks China after extending control to all of Manchuria
  2. Unbroken warfare for China from 1937 to 1949
  3. End of pacific war in 1945 only begins Nationalist vs. Communist war
2. Rise and Fall of Japan Centered East Asian Economy
  1. Distinct Japanese structure
    1. Core - Japan: All manufacturing and services reserved for Japan
    2. Inner Circle - Taiwan and Korea: Food production for the empire. Improved transportation, education, health care and agriculture
    3. Middle Circle - Manchuria: Production of agricultural materials and industrial materials for Japan
  2. Japan exceeds Britain to becoming the largest foreign investor to Shanghai.
  3. Defeat in Pacific war destroys the Japanese structure.
  4. China withdraws from East Asian economy

## **Rise of Manchuria**

1. Industrialization accelerate during early war years when other states declined.
2. Produced bulk of electric power, iron and cement
3. Majority of China's industrial capacity in Manchuria

## **Increased State Intervention**

1. Natural Resources Commission (NRC) runs government sponsored development.
2. Central planning a response to wartime pressure
3. Shanghai firms converted to produce Japanese military materials. Consumer goods fall. KMT regains factories from Japan in 1945.
4. KMT controls 2/3 of modern industrial capital and 90% of iron and steel output. Also control banks and transportation companies

## **Inflation**



1. Nationalist government tried printing money to finance operations = hyperinflation

## **Legacies**

1. Socialist Era (1949-1978)
  1. Extreme disruption and serious damage to economic infrastructure
  2. Financial chaos from hyperinflation
    1. KMT heavily crippled
  3. Poverty
  4. Thus, ease of becoming socialist
    1. Deeply suspicious of West and Japan. Strong aversion against foreign dominance
    2. Closed door socialism the answer
    3. Chinese very willing to accept repressive government
  5. Wartime economic changes also ease Socialism
    1. Heavy industry laid by Japanese seized by Soviet Army and passed to Chinese government hands
    2. CCP establishes direct control over industrial sector
    3. Skilled officials from NRC stayed on to work for CCP.
  6. Good literacy rates that were increasing
2. Post 1978 Market Economy
  1. Traditional economy also very important to post 1978 market economy. China was already used to market forces pre 1900s.
  2. China's opening is a remembrance of the traditional household based economic system. Easy to adopt new economic opportunities.
  3. Small households businesses returned - township and village enterprises
  4. Macro regions revived with astonishing speed. SEZs revived as Hong Kong and Taiwan underwent rapid growth in 1960s and 70s. Reintegrated with PRC in 1978.
  5. SEZs - a small step by step method to re-welcome the otherwise taboo foreign interaction. Limits the scope of foreign incursion.
    1. Also known as 'dual track' approach - a defining feature.

## **Chapter 3: The Socialist Era 1949-1978: Big Push Industrialization and Policy Instability**

### **Introduction**

1. Turning backs on 'bottom heavy' economy, moving towards socialist framework
2. Ignore labor intensive advantage and went capital intensive (massive investment into heavy industries)
3. Coastal development discarded, looked inward
4. Different interpretations of socialism = unpredictable policies = disruption to economy

### **Big Push Development Strategy**

1. Consumption squeezed, rapid industrialization
2. All control to government that ended in all resources to construction of factories (usual developing countries invest 20%, China gave 26% and more in GLF)
3. Economic growth jump started and economy took off in 1950s
  1. Mirrors Hong Kong and Taiwan (but they went Light Industries)
  2. Hong Kong, Taiwan and Singapore moved to heavy soon after. Leap made with openness to trade.
  3. Faster progression compared to China
4. Industries are value chains spanning from resource extraction to refining to final products
  1. China's industries strategic as heavy industries (steel) final products have multiple linkages with other industries
    1. Downstream to other products (machinery)
    2. Upstream to demand related products (coal, iron)
  2. Bodes well for self reliance

### **Command Economic System in China**

1. Stalin Influenced System
  1. Government ownership of all factories, transport and communication systems. Agriculture controlled by government based collectives
  2. Planners assign production targets to firms also assigns inputs.
  3. Finance used to audit performance not drive investment decisions
  4. Prices set by government and channeled towards big push.
  5. CCP controls managerial career paths
2. Modifications by Maoist Ideology (to fit a poorer nation)
  1. Government monopoly over agriculture goods fixed at low prices
  2. Such goods (cotton) made input cheap for manufacturing sector
    1. Heavy industries viewed to be of 'high profit' even though not efficient
  3. Taxes not required as government raised 25+% of GDP via budgetary revenues.
  4. Material balance planning used to run the economy instead of prices. (Quantity based)
  5. Nomenklatura system (controlled urban jobs) used to control personnel as it was the highest incentive at that time.
  6. Wages kept low and stable
  7. Agriculture = Low Return, Manufacturing = High Return
  8. Farmers want to leave but restricted by Government
  9. Central control not effective due to poor communication unlike Stalin's Russia + Lack of command at the base = Middle Management had most authority (local government officials)
  10. Only ideological and social (migration) control was tight

### **Political Instability**

1. Summary
  1. Sharp turns in unique policies = Political conflict
  2. Policies used as weapons in internal party conflict
    1. Mao changes in policies are based on personal thoughts and struggles against political opponents
2. Economic Recovery 1949-1952
  1. No consensus on how fast China can build a soviet system
  2. Wartime losses + Capitalist attacks + Invasion of South Korea pushes China to close links with Soviet Union
  3. Effective adaptation of communist ideology to political and economic challenges
    1. Radical Land Reform
      1. Redistribution of 42% of arable land to the poor. Gained support and destroyed the power of landlords
      2. Takeover of factories including Manchurian / KMT's in urban areas
    2. 'New Democracy' move triggers influx of non communist to join and help build the country
3. First Five Year Plan - Twin Peaks 1953-1956
  1. Constant policy adjustment focusing on
    1. Pace of transformation
    2. Degree of centralization
    3. Wages & incentives in urban areas
  2. Soviet top but mixed economy on the bottom
    1. Important as it resulted in huge success
  3. Plan focused on moving industries inland with 156 industrialization projects
    1. Huge soviet assistance with crossing of advisors and students
    2. High success and inflation from investment surge curtailed
    3. Agriculture still an open market but government begins owning produce (grain)
  4. Second Peak - 'High Tide of Socialism'
    1. Mao criticizes officials of slow public ownership of all resources - heightened campaign and speed of socialist transformation
    2. Urban factories converted to government ownership.
      1. High government investment

### **Retrenchment: The 'Hundred Flowers' 1956-1957**

1. Nikita Khrushchev denounces Stalin freeing all Soviet countries to run the way they like
  1. China relaxes political environment
2. Problems arise due to quick changes imposed earlier
  1. 5 million workers absorbed to state sector, half of which are rural-urban migrants
  2. Increasing average wages with flood of new bank credit financing infant agriculture cooperatives
    1. Agriculture stagnated and output fell drastically
  3. Supply of goods fail to meet increasing demand
3. Pace of change had to be modified - Now preaching gradual change
  1. Eighth congress debates policies openly and decides market mechanism would solve issues.
  2. Small period of liberalism the foundation of post 1978
    1. Extraordinary rapid economic growth
    2. Industrial production expands 17%
    3. Groundwork for future growth in place with investments in education and training
    4. Short-lived as Mao starts the GLF

### **The Great Leap Forward 1958-1960**

1. Mao initiates anti rightist campaign, arrests 800,000 outspoken individuals and sends them to labor camps
2. GLF dominated by intoxicating politics with an aim to go fully communist
3. GLF = intensive version of Big Push strategy. Resources transferred from agriculture to industry
4. Innovated elements
  1. Communes established - Large scale combinations of governmental and economic functions to mobilize labor for construction, provide social services, develop rural industries
  2. Incentives and monetary rewards stopped
  3. Decentralized control of decision making
  4. Marrying low end 'poor' technology with imported advanced technologies
5. Tragedy
  1. Lucky harvest + high steel output gives officials wrong info
  2. Officials inflate claims of growth. Blinded by ideological fervor
  3. Fateful Decisions - fed by wrong science that deep plowing will yield 3x:
    1. Reduced agriculture, especially food (Less Food)
    2. Increased compulsory deliveries of food to state (More Food Taken Away)
  4. Initial huge growth surge with agriculture plots given for commercial use (cotton)
  5. Laborers made to work overtime to maximize growth
  6. So focused on quantity output to surpass Britain and America that quality was not considered
  7. Worst still, unsustainable food.
  8. Mao attacks concerns of a lack of food interpreting it as a push against his GLF. Another anti-rightist campaign against those among their ranks.
  9. GLF pushes even harder. Reserves drain and China enters crisis with 1960 famine
    1. 25-30mil excess deaths mostly inland rural areas as coastal areas were maintained to look 'normal'
    2. Soviet Union pulls out, permanent rift with China

#### **Retrenchment: Crisis & Readjustment: 1961-1963**

1. 180 degree change again with new policies rammed through
  1. Lowered investment
  2. Workers sent back to countryside
  3. Communes restructured with responsibilities of farming back to households
  4. Factories shut down nationwide
  5. Economic control re-centralized
  6. All necessities rationalized
  7. More focus on agriculture, starts importing food

#### **Launch of Third Front 1964-1966: New Expansion Hijacked by Radicalism**

1. Mao looks towards a third front focused on inland provinces to avoid American or Soviet military pressure
2. Construction of factories and railways inwards
3. Rapid expansion halted by radicalism

#### **Retrenchment: The Cultural Revolution 1967-1969**

1. Mao encourages students called Red Guards to overthrow government except himself. Seen as:
  1. An attempt to revive the revolutionary spirit to cleanse China of bureaucratic tendencies
  2. A Machiavellian plot to purge Mao's political opponents
2. Not much of an impact economically
3. US threat in SEA decreased but clashes with Soviets begin.

### **Maoist Model: A New Leap 1970**

1. New leap focused on Third Front again with industrial constructions
2. Country operating close to Martial Law with army called to quell factional fighting
  1. Also due to impending threat from Soviets
3. Instead of doing everything simultaneously, people told to tighten their belts and give everything to construction.
4. Policies seem to bear fruit and production surpasses pre CR growth.
5. 5 elements different to Soviet system:
  1. Pervasive militarization of economy
  2. Decentralization operation of economy - Rural industries encouraged
  3. Autarky (self sufficiency as national policy) practiced. Nearly no economic links with outside countries
  4. Near zero material incentives
  5. Market driven labor mobility virtually ceased - government directs manpower and school leavers sent to countryside

### **Retrenchment: Consolidation and Drift 1972-1976**

1. Industrial growth outpaces agriculture again = pressure on food supply
  1. More and more power placed in construction but food to support such manpower was missing
2. Top military leader removed in political play. China embraces US and leadership repositioned to address emerging problems
3. More moderation
  1. Investment cut back
  2. Focus on Third Front reduced, back to more efficient coastal regions
  3. Economic ties with capitalist re-established, fertilizer plants brought into China from US-Dutch
  4. Deng brought back to power and then ejected again in political chaos
4. Mao refuses to admit that CR was a mess and sets a Gang of Four to repress such notions. Deadlock in leadership.

### **The Great Leap Outward: 1978 - End of Maoism**

1. Mao's death in 1976 allows leadership to overthrow Gang of Four and refocus on economic matters
2. Focus on data collection and rehabilitation of infrastructure
3. New leader Hua Guofeng envisages 120 major projects in heavy industry. He believes that economy will take off if Leftist ideas are purged
4. Plan fails due to faulty calculations
  1. CR damage decimates leadership's ability to address problems of absorbing new technologies, managing resource flows and coordination of multiple resource flows
  2. Too many trade deals with outside countries resulting in 40bn worth of projects and 7bn worth of trade deals
  3. Oil fields that were used to increase exports (to pay for projects) failed due to depletion of main field

### **Final Turning Point: The Third Plenum & The Beginning of Economic Reform**

1. Political factors finally come together, Deng returns to power allied with veteran CCP leaders - all open to free market
2. Free discussion of otherwise taboo topics

## Legacies

1. Political Instability
  1. System works by channeling power to a discretionary head but the heads (Mao) have often failed with political struggles
  2. The 'ceiling' of agriculture to rapidly generate food surplus was never breached
  3. All these cause dissatisfaction with standard socialist system even among the CCP
  4. Inherent political divisions allow new leaders to blame Mao
  5. Past experiments enrich new leaders with valuable experience
2. Shortcomings of Development Strategy
  1. Neglecting consumption in pursuit of development
  2. Neglecting growth in services, normally services grow as countries advance
    1. Meaning lack of competition so quality diminishes
  3. Slow employment creation
  4. Lack of technology and slow technology infusion prevents heavy industry for taking off
3. Human Capital Base
  1. This is where the socialist environment did well
    1. Education
    2. Healthcare
  2. Although CR shut down universities, primary education which is more important, flourished.

## **Chapter 4 - Market Transition: Strategy and Process**

### **Introduction**

1. Market transition begins at end 1978 via waves of reform
2. Some reversals here and there
3. Transition not complete
4. Reform began in rural areas
5. 2 phases
  1. Gradual, dual track aimed at decentralization
  2. Marketization - reforms more fundamental and thorough by remaking current institutions to fit markets

### **The Chinese Approach to Transition**

1. Development can never halt. It must continue even with transition. (gradual)
  1. Reform policies judged based on contribution to growth and development
  2. Opposite of Soviet/Russia (big bang)
2. Result of not having a blueprint, so going safe and sure and hoping to find ways to solve the problems of a planned economy
3. Big Bang:
  1. Quickly shed communism quickly
  2. No faith in government to be able to clear distortions
  3. No faith in mandate since they were ousted communists
  4. Better to push through and start from scratch. Ignore short term costs
    1. But short term costs were very much deadly, greater than expected
4. Gradual:
  1. Manage unmet needs first
  2. Allow earning of additional income to clear some command legacies and increase income
  3. No removal of system but loosened central control
  4. Tiny problems ignored:
    1. Early reforms create some loopholes of lightly taxed, but they were allowed as they contributed to growth
    2. Niche markets sprung up for exploitation but this led the way to a competitive environment
  5. When tiny steps are in place, begin marketization by removing dual track plan
  6. Successful

### **How Did Reforms Start? Countryside Breakthrough**

1. Social relaxation after CR
2. Ease rural regulations by reducing agricultural requirements from farmers, raising prices of produce that is above the requirements
  1. Hard choice because investment had to make way
3. Collectives allowed to experiment with different payment systems and organizing methods for output
  1. More innovation
  2. Ended up with land divided and collectives only collect what is regulated and procured for plus tax. Households have control of the rest.
  3. Universal by 1983, agriculture production surges
  4. Farmers increased productivity and produced more in lesser days
    1. Shifted labor to non agriculture. Sprouted TVEs - locally run factories.
    2. New output from a brand new sector (TVEs) now challenged SOEs and provided for market sectors not covered

## Two Phase Framework of Economic Reform

1. Reforms had occurred without significant disruptions due to dual track system
2. The contract system that rural reform used (contracting land) was observed to be successful as it included government interest plus gave farmers incentives to produce more
  1. Extend to industrial and commercial sectors
3. Reform by decentralizing power, more local power, less barriers to entry
4. Now at 1993, reforms move on as economy has 'grown out of plan'
5. Now look at marketization

## Elements of China's Transition Through 1992

1. Introduction
  1. 1980s reform led by Zhao Ziyang, who was 'controlled' by Deng Xiaoping and Chen Yun.  
Thus, reform is less gradual
2. Dual Track System
  1. Refers to a traditional plan + a market channel for allocation of goods
    1. Keep the plan to ensure stability but expand it to allow some market forces
  2. Implementation of 2 tier pricing system
    1. Low price state planned price
    2. High price market set price
  3. A co-existence of 2 mechanisms and not 2 owners
    1. SOEs still dominant and produces for 2 mechanisms
    2. Important as factories had time to learn the market system
  4. Some private firms came in with collectives and also foreign invested enterprises (FIE)
    1. These were market based from the start
3. Growing Out of the Plan
  1. The state controlled portion of the dual track system was fixed in absolute terms
    1. As the entire system grew, the state section became smaller and smaller
  2. Central government allocated steel output usually grew in step with production but this soon fell
    1. Local government allocation increased
    2. Market channeled steel vastly increased as well
  3. Grew out of plan in 1993
  4. State quota on each firm was like a fixed tax, so as firms made decisions on the margins, all decisions were market based.
    1. Plan now irrelevant
4. Particularistic Contracts
  1. Multiple varying contracts signed between planners and SOEs.
  2. Specified payments and contributions
  3. No standard tax, all unique based on firm performance
5. Entry
  1. Government's monopoly over industry now relaxed
  2. Industrial sector no longer protected
    1. Large inflow of startup firms especially from rural industries
  3. High level of competition even for SOEs
6. Prices Equating Supply & Demand
  1. 1980s onwards, prices were at market rates
  2. 1985: market prices are legal for exchange of goods outside the plan
  3. System already in place for market prices
  4. Firms begin to look for ways to reduce cost via subcontracting to rural non SOEs to improve profits
7. Incremental Managerial Reforms
  1. Experiments to improve incentives for SOE managers without the need to privatize
  2. Focus on profits instead of fulfilling plan



3. SOE performance improved by debate continues if privatization is better
4. Managerial reforms instead of privatization prevents the short run abandonment of the enterprise syndrome from occurring
  1. Again stability is preferred
8. Disarticulation
  1. Pushing reform the hardest in sectors that are least tied to the planned economy
  2. Successive sections moved away from the core
    1. Prevents disruptions to the core
    2. SEZs are example
  3. Strategy not intentional but a result of wanting to keep the core stable
  4. Policy makers see things differently now
    1. There's no need to integrate rural industries into the system
    2. Instead poorest regions were allowed to separate as long the state could purchase enough grain from them
  5. This strategy is based on caution
9. Initial Macroeconomic Stabilization Achieved Through the Plan
  1. Reformers faced serious macro imbalances in 1979-1981
    1. Solution is to use institutions of planned economy to cut back investment and relieve pressure on economy.
    2. Planned economy was used to shift resources to household sector
  2. Paved the way for market development
  3. Did not have to take the capital intensive Big Push method
  4. Inflation pressures were countered with quick growth in supply
  5. Key is the use of planned economy only under short term
    1. Lowered unemployment
    2. Preserve stability
    3. Preserve support for reform
10. Continued High Saving & Investment
  1. Only a gradual takeover of national savings from government by households
    1. Made possible by stability
  2. Government reduced their share of GDP to allow rural & urban households more resources and more incentives
    1. Increase in income = increase in savings (voluntary) = belief in asset security = faith in economy
  3. Increase in private savings offset decrease in government savings (caused by decrease in revenues due to the dissolution of industrial monopoly)
    1. National savings remain high = high investment and growth
  4. Start of the role of the banking sector to manage private savings and channel them to enterprises
11. Conclusion
  1. A success although it faced the problems of "two steps forward, one step back"
  2. China continued to go under macroeconomic instability via business cycles
  3. Harder for planners to control as there was no 'false stability' which is a good thing
    1. But undermined support for reformers

## **Reform Without Losers**

1. 1980s - Rare that any major social group suffer any large economic loss
  1. SOE employees protected
  2. Rural residents gained shares due to reform
2. This made the reform popular even after the Tiananmen incident

## **Tiananmen Interlude**

1. 1988-1989: Caused by

1. Rising inflation = fall in real incomes
  1. Sense of a failing government
  2. Anger at corruption and privileges
  3. Increasing expectations of political and economic change
2. Reform leader did not want to use force to clear protest and was toppled. Conservatives used force and reformists were exiled.
3. But market transition resumed after 2 years as the foundations for reforms were already in place and it was left to the dynamics of the process.
  1. Even though conservatives tried to roll back, they couldn't
  2. Market forces quickly corrected imbalances
  3. Conservatives support in the CCP fell as their plan was ineffective
  4. Deng Xiaoping rises with Southern Tour
    1. SEZs, setup 10 years before, were doing very well
    2. Deng pushes for more reform, delineating it from politics citing development as key
4. Birth of socialist market economy in 1992

## **The Second Phase of Reform (1993-Present) / Reform With Losers - Perquisites**

1. Introduction
  1. Zhu Rongji takes over as premier
    1. Strong and decisive leader that makes quick personal decisions
  2. Essential policies:
    1. Ending the dual track system
    2. Recentralization of fiscal resources
    3. Macroeconomic austerity
  3. Reformists now focus on regulatory and administrative restructuring of:
    1. Banking
    2. Taxing
    3. Corporate governance
    4. WTO entry and trade
2. Market Reunification
  1. Dual track system dies off without a whimper
  2. Allocation of materials abolished
  3. Particularistic contracts allowed to lapse as financial side was under high reforms
3. Recentralization
  1. Even though decentralization was key in the first reform, it was important to properly divide responsibilities between the central and local governments
    1. Division of management responsibilities
  2. Center was strengthened so it could maintain ultimate control of resources and also be able to set regulations and manage the macro economy
    1. Funds needed and government revenues were dipping heavily in 1995 (due to erosion of old system, and a result of a transition strategy that focused on lowering government resources, moving them to local control)
    2. Important to clear fiscal crisis
    3. Beginning of tax reforms, tax base widened
4. Macroeconomic Austerity
  1. Inflation caused by Deng's remarks about SEZ that caused a flush of credit to SEZs
  2. Zhu responds with macro restraint and a crackdown to ensure credit is less cheap when delivered to SOE.
    1. Slows growth of money and prices
  3. Macroeconomic stability ensues as public enterprises are held accountable for their own profits and losses
    1. Tougher budget constraint

## Reform With Losers - Regulatory Approach and Administrative Restructuring

### 1. Introduction

1. Zhu initiates new rules and prices that are applied equally to all economic actors
2. Focus on creating and regulating competition as a force for economic change
  1. No longer direct government action in managing enterprises
3. Economy has grown out of plan. Important to improve legal and regulatory environment.
4. Done in 4 sectors via:
  1. New fiscal system
  2. New foreign trade system
  3. New company law

### 2. Fiscal & Tax System

1. Increased tax base via 17% VAT and other business taxes
2. Lower rates than old system
3. Uniform tax applied to all economic actors
4. Central received more taxes successfully and quickly set rules on redistributing wealth to local governments

### 3. Banking and Financial System

1. Old structure of the People's Bank of China made it only available to central and provincial officials
2. New structure in 1998
  1. All provincial level branches removed
  2. 9 regional branches set up
  3. Monetary Policy board - Central Bank gets an active role
3. Add on to current macro economic austerity
  1. State run commercial banks face tighter budgets with no access to easy government money
  2. Tough stance passed on the customers of such banks (SOEs)
4. Tackle lax financial supervision and non performing loans
  1. Setup 4 asset management corporations to take over bad loans (liquidate them)

### 4. Corporate Governance / Company Law

1. 1993: Company Law passed containing:
  1. Provisions for all SOE to reorganize as limited corporations with clear corporate governance institutions
2. Changes the Chinese public sector
3. Combined with selective listing of SOE on China's new stock market
4. China Securities Regulatory Commission forms a central network of security supervisors to regulate new corporate structure.
5. Loopholes in regulations filled by new offices such as the State Intellectual Property Office and State Administration of Technical and Quality Supervision

### 5. External Sector / WTO / Trade

1. 1993: Extensive foreign trade reforms passed to unify China foreign exchange regime.
  1. Currency devalued
  2. Establish current account convertibility
2. All steps required in order for China to join the WTO
3. Joined in 2001
4. A new chapter for China as China has to accept a broad range of regulations
  1. Foreign companies, goods and investments are now welcome

## Reform With Losers - Outcomes

### 1. Inflation to Price Stability

1. Post 1996, inflation is tamed
2. Huge expansionary phase occurred in 2002 and government focuses on price stability

3. Price stability + High competition = pressure on Chinese firms, especially public enterprises
2. State Enterprise Restructuring and Downsizing
  1. Close ties between government and SOEs cut.
  2. Public firms now facing plenty of market pressure
  3. SOE restructure to downsize and cut costs to remain competitive
    1. Convert ownership to more explicitly known and legally defined
    2. Sometimes privatize
  4. Local government given free rein to push for reforms in this sector
    1. Power over bankruptcy, sales, auctions, mergers, etc
  5. Between 1978 and 1993: State sector shrinks to its rightful size and importance
    1. Continues to grow in both output and employment (absolute terms)
  6. After 1993: State sector employment falls by 40%
    1. Profits fall from 15% of GDP to only 2% (no longer cash cows)
    2. Local government find that it's not worth to keep such SOEs
3. Privatization
  1. Not openly embraced and pseudo terms like 'restructuring' is used
  2. But common in TVE, collective and SOE after mid 1990s
    1. Management buyouts
  3. Rise of private businesses as well with such businesses given more recognition and legitimacy
    1. 55million employed in private firms compared to 33 million in SOEs
4. The Losers
  1. State enterprise workers
    1. Millions laid off
    2. Millions abandoned failing firms
    3. First time subjected to employment uncertainty
    4. Losses in income and social standing

### Contemporary Challenges

1. China's 2nd shift approach was more common to countries like Poland and Czech Republic
  1. No more polar opposition between big bang and gradualist
2. Ideas that can be learnt from China
  1. Policy making process has been complex
  2. Multiple differing outcomes occurred in gradualist reform
  3. Some argue that China's underdeveloped stage gave China the advantage of a large, flexible, rural economy that was the springboard for reform
    1. But underdevelopment has its costs as well and cannot be said to be only a clear advantage
  4. In both stages, reforms were effectively adapted to specific challenges and opportunities in China. 2nd stage reforms were more dramatic as the new set of challenges were drastically different
  5. Careful policy making that is firmly grounded in local conditions is key as compared to a prepackaged set of policies
3. Coming challenges
  1. 2nd set of reforms more profound and drastic but many institutions created are not yet adequate
  2. Financial System is still state owned
    1. Influenced by good connections and government
    2. Weak legal accountability (bad loans that could lead to government bailouts)
  3. Tax system re-constructed but fiscal relations between central and local governments are not well specified
    1. Local fiscal capacity gravely underdeveloped

4. Chinese corporations are far from world class standards in terms of corporate governance
5. Chinese regulatory agencies created but not fully independent from government management bodies (areas where they were spawned from)
6. Challenges are more political
  1. China is in need of a more transparent legal regulatory system based on fairness
  2. This touches the ultimate structure of political power
  3. Efforts made to strengthen checks and balances but all self policed by CCP
  4. Powerful interest groups still involve cooperation of political and economic allies
  5. Corruption is a serious problem because it obstructs resolution of other problems  
= no true level playing field
7. Inequality rising - After SOE employment smashed
  1. Need for social security net
  2. Commitment to WTO limits China's ability to protect the majority of its population against foreign competition
  3. Employment problem must be resolved not just with job but better wages and ensuring no underemployment of labor

## **Chapter 5.1.1 Origins of the Urban - Rural Divide**

### **Early Reforms**

1. Roots from socialist period due to different styles of re-organization of working areas in urban vs. rural places
2. Urban residents organized by place of employment and went under state ownership
  1. 2 consequences
    1. Knit in a formal hierarchy subject to central planning
    2. Built up a system of social benefits
  2. Urban residents became the privileged group
3. Rural residents were denied land and land was pooled and given in collectives per village
  1. Done without mechanism to redistribute resources
  2. No standards or entitlements
  3. They had to support social services out of their own resources
  4. No claim on national resources
  5. Rural = poorer and lesser social benefits/security
4. These tools were used to drive the big push policy
  1. Rural System: Extract low cost food and fibers and give it to the government and urban dwellers
  2. Urban System: Receive government investment, considered the vanguard of socialism
5. Farmers feel very unfairly dealt with, government have to tie them to their lands to continue control. Urban migration banned.
  1. Household registration first used to monitor census but now turns into a control method
6. During famines, the rural dwellers were first hit because urban areas were protected
7. Government finally stopped such bias benefits after GLF to encourage citizens to return to rural side.

### **Successful Rural Reforms (Early 1980s)**

1. Rigidities relaxed
  1. No more grain rationing
  2. No permits needed for eating
  3. Increased availability of grain
  4. No more migration restrictions
2. But some remain
  1. Permit exists and marks fundamental divide
    1. Some benefits still tied to permit
    2. Permit no longer needed for license to live in the city but lacking a permit = no urban benefits
  2. Remaining benefits include
    1. Social security
    2. Healthcare
    3. Education for accompanying children

## **Chapter 5 Continued**

### **The Urban Economic System**

1. The Danwei
  1. Urban life associated by Hukou - Urban residence permit
  2. Membership in Danwei - A guaranteed job after graduation in a work unit
  3. Benefits
    1. Job security
      1. But once employed in that sector, bound to that sector for life
    2. Low price access to food and other scarce commodities
      1. Distortion of price system
    3. Healthcare
    4. Pension and health benefits on retirement
    5. Primary and middle school education for children
    6. Low cost housing
  4. Work Units
    1. Can be SOEs or nonprofit public service unit
    2. Common features
      1. Integrated into national administration
      2. Leaders appointed by CCP
      3. Benefits listed as entitlements part of an implicit urban social compact that is protected by the government
      4. Work units responsible for social and cultural activities
      5. Political co-ordination
    3. Seen as the fundamental building block of urban society
  5. Danwei = a microcosm of urban society where you are born to, work in and die in.
2. Urban Property Rights
  1. Like the Danwei, all urban property was incorporated into a national hierarchy of state ownership
  2. All urban land nationalized in 1950s
  3. Large urban business all state owned
  4. Municipal government budgets treated as subdivisions of national budget
  5. China embraced development of small scale enterprises, now impossible to exercise authority over so many small and far assets
    1. Authority given to local governments
    2. In time, property rights were handed over to the local governments
    3. Growth in power of local authorities over cash flow and use of assets
    4. Thus, urban reforms focused on lines of authority between central and local authorities
  6. Change in 1990: Market for transferable urban leaseholds emerges
    1. Use rights of occupants usually recognized
    2. Can buy and sell land with permission of local government
      1. But taxed as well

### **The Rural Economic System**

1. Rural Collectives
  1. No attempt to integrate rural areas to above mentioned urban - national hierarchy.
  2. Rural has its own country side hierarchy
    1. From county level to township level
    2. However, it is outside the government system
    3. Theoretical autonomous organizations
      1. Looser control by the government as compared to city

3. Thus, low power organizations that had no entitlements to government services
4. Rural collectives did not have enough resources to start their own subsidies
  1. Payment burden fully on rural residents
2. Rural Property Rights
  1. Rural property never incorporated into national state ownership.
  2. Collectives own the land and all enterprises (even non agricultural ones)
  3. Rural households always have access to their land and retain own houses with access to farmlands via collective
  4. 1978-1984 reforms ends collective farming in all of China.
    1. Land divided among households based on family size
    2. Formal ownership still with the collectives even though households worked the lands
      1. Farmers sign contracts with collective for land use rights of up to 50 years.
  5. Side Effects
    1. Redistribution of land occurs periodically to accommodate population growth
      1. Household use rights thus subject to changes during such periods
    2. Very little landlessness
      1. Local guarantee of some land for everyone is the most important countryside safeguard
      2. Except in some poor and remote areas where households have de facto ownership
    3. No completely secure land tenure = Farmer's incentives fall
      1. No reason to invest in the land for long term
      2. Land cannot be used as collateral for borrowing.
      3. If families migrate to cities, they lose their land
        1. Encourages some of the family to stay behind
3. Fuzzy Property Rights and Land Use Disputes
  1. Complex rights with multiple local negotiations.
  2. No national registry where property rights are inscribed, only village registries
  3. Cities are requiring more land and encroach on rural land. Increased in opportunities for village heads to lease or sell land to cities.
    1. Corruption: such officials find ways to enrich themselves
    2. Farmers lose out and react with anger when compensation is not adequate as land are their lifelines.
      1. Mass protests at local levels
  4. New law in 2003 to guarantee farmer's property rights and provides guidelines for fair compensation
    1. Rural residents are demanding more rights still
  5. Affects to direction of rural nonagricultural enterprises (TVEs)
    1. Such firms owned by collectives
    2. Use rights delegated to firm managers
    3. Fuzzy negotiations that produced effective organizations due to flexibility in negotiations
4. Evolution of Rural and Urban Systems during Market Transition
  1. Elimination of agricultural collectives in rural and permanent employment in urban
    1. Danwei not important anymore
  2. Different dynamics in rural and urban
    1. Rural
      1. Easier to change as more loosely organized
      2. Supply of rural public goods collapses and government doesn't step in as it never had before
    2. Urban
      1. Harder to change as social benefits were in the past guaranteed
      2. Government had to defend some rights in order to not break those agreements



3. Social functions stripped from SOEs and to turn them into profit orientated businesses
4. Cannot strip the social safety net so redesign is the only option left.
5. Extensive support for health and social security still remained
  1. Urban workers pay for some health insurance but state still covers a large part of it.
3. Differences:
  1. Rural dwellers pay larger share for health care still even though they are poorer
  2. Urban residents could purchase their houses from work units on favorable terms
    1. Cheaper based on seniority
    2. Ownership leads to booming market in durables and home improvements
    3. Able to sell housing after 5 years
  3. Thus rural and urban gap continued
5. Invisible Walls: Administrative Barriers Today
  1. Household Registration System
    1. Registration for a specific location and status (urban or rural)
    2. Hard to change status
    3. Children inherit status from mother
      1. Rural women cannot change children status by marrying urban resident
      2. Breaks tradition of women living in with their husbands
      3. This system was changed in 2000 when children can inherit status from either parent.
  2. Access to Hukou substantially liberalized but still exists
    1. But more ways to obtain Hukou. Just find a job and be employed for a year.
      1. Tougher to do that in large cities for poor migrants
      2. Easy for graduates (demand for knowledge based cities) and wealthy (buy out or invest in city businesses)
    2. Also can stay in the city without a Hukou via temporary registrations
      1. Some social services are available to such migrants
    3. Reform to Hukou is a slow process
      1. Downsizing of SOE = high unemployment = preference to keep rural migrants out
      2. Public services are expensive and governments do not want to extend them to migrants
      3. Migrants face exploitation as factory managers want to keep them in a weak bargaining position (sometimes not even paying them)
        1. Program enforced make sure they pay up but not largely successful
      4. Hard to reform also because of powerful interests at stake and dramatic differences between rural and urban systems (differences entitlements - when do you gain one and lose another?)

## Urbanization

1. Rapidly urbanizing, agriculture falling in share of GDP but majority of people live in the country side
2. Current trend of urbanization is similar to global trends but before this it was bizarre
  1. Usually pace of urbanization is determined by individuals who want to move
  2. In China's case its policies as individual choice is constrained
3. Trend
  1. China's urbanization rate was low + post 1950s and in 1978, China actually de-urbanized
  2. After 1978, urbanization rate is equal to global rates

3. Pre 1978 figures show impact of China's rules on population movement
  1. Forced out-migration also in the CR
  2. Shows degree of political control in Maoist China
  3. 1978 saw the end of such extreme controls
4. Borders between urban and rural areas now blurred as big cities like Beijing sprawls outward
5. Future challenges for China as it has to handle waves in urban migration with non Hukou holders outstripping that of holders

## **Rural Urban Migration**

1. Introduction
  1. Increasing migration but there is still discrimination and limitations on migrant's integration into society
  2. Long hours, sleeping in substandard housing
  3. Most plan to return to countryside
  4. They need access to education, housing and social services that full urban residents have
2. Overview
  1. After being barred for a long time, their reappearance evoked complex and negative reactions from city dwellers
  2. Floating population stands at 12% of total population
    1. 65% of the above living in the same county
    2. Another 79 million are in different county living on long terms
    3. Floating population is increasing dramatically
  3. Migrants attracted to booming southern coastal provinces
    1. Especially Guangdong Province
  4. 20 million are permanent migrants who succeeded having household registrations permanently transferred
    1. Very different from floating
    2. Mostly educated and urban in origin but moved for education sake
3. Migrant Characteristics
  1. Push/Pull factors are based mostly around economic opportunity (jobs available and wage levels)
  2. Young, male rural residents are most likely to migrate
  3. Females are catching up in migration as well since export orientated factories prefer female workers

## **Economic Consequences of the Urban-Rural Divide**

1. Introduction
  1. Inevitable gaps in development process
    1. Rural residents equipped with less capital suffer economic impact of remoteness and incomplete markets for many required resources
    2. Industrialization began first in cities and modern economy is located there.
    3. Urban hold higher incomes and rural have slower income growth.
2. Living Standards and Restrictions on Mobility
  1. Wage freeze used to stop rural-urban migration did not help reduce urban-rural gap
    1. Urban employment began to take in women meaning urban households had 2 breadwinners
    2. Birth control also reduced dependent children
  2. Rural incomes stagnated. Increase in labor in the country was bottled up in rural areas, thus MPL fell.
    1. Prices of agriculture goods were fixed so Marginal Value Product fell too.
  3. On top of that subsidies enjoyed were another non monetary difference as well

1. On hindsight, prices in cities are higher but that doesn't even out the gap much
4. Entry to the WTO = economic pressure on Chinese farmers
  1. Import liberalization affect farm prices. WTO places upper limit on Chinese farm prices preventing them from rising above global farm prices
  2. 13m jobs lost in wheat, cotton and rice production
    1. Offset is in the textiles, apparel, commerce and construction industries based on comparative advantage.
    2. These are urban centric (secondary industries)
  3. Thus downward pressure on rural incomes = further gaps
3. Addressing the Urban - Rural Divide
  1. Policies put in place to prevent divide from growing bigger
    1. Abolishment of agriculture tax
    2. Direct subsidies implemented for farmers (grain)
      1. Designed to protect rural income and not prevent migration
    3. Sunshine policy gives job training for soon to be urban migrants
  2. But such policies have to be combined with policies at the local government level for it to be effective and integrate migrants into society.

## **Chapter 6: Growth & Structural Change**

### **Introduction**

1. Some unique aspects of China
  1. Higher investment than other economies
  2. Focus on manufacturing more than any other sector
  3. Grown a lot faster than other economies
  4. China is at a stage of development where a rapid structural change causes high speed growth

### **Growth**

1. Introduction
  1. Fast growth between 1949 and 1978
  2. Real growth took off at 1978
    1. Coincided with slowing of population growth which boosts per capita calculations
2. Data and Measurement of Growth
  1. Official Data:
    1. 1952-1978: GDP 6.0 Population 1.9
    2. 1978-2005: GDP 9.6 Population 1.1
  2. Statistics may be skewed because the economy is in transition and it's hard to collect accurate stats
  3. China also made a transition to a new data collection system
  4. 3 sets of problems affecting data reliability
    1. Prices - Does not correct for inflation
      1. GDP deflator grows more slowly than in any other measure of inflation
      2. Inflation is not high now so not an issue
    2. Coverage
      1. China's quick move into the high tech industry causes counters to count high tech goods at old high price values. (overstate growth)
      2. But counting healthcare and housing at low old prices understates growth
      3. Net effect unclear
    3. Politics
      1. National Bureau of Statistics has monopoly over data
      2. Data are success indicators and officials have incentives to distort it.
      3. CCP has monopoly over press and have never revised their growth rate downwards
3. Growth in Comparative Perspective
  1. China's growth is undoubted because:
    1. Exports are growing faster than GDP (verified by the import numbers of other countries)
    2. Adjusting for inflation in 1980s and 1990s and also undercount of GDP in 1978 - Revised GDP figure stands at 7% which is close anyways
    3. >6% growth in GDP is not new. Japan, and other East Asian economies grew at similar rates
  2. China's growth is unique compared to other East Asian economies because it is going strong even after 27 years unlike the others who grew at slower rates post 1997 crisis.
4. Instability in Growth
  1. Pronounced cyclical pattern in GDP after 1978
  2. High peaks caused inflation and sectoral bottlenecks
  3. Followed by retrenchment and slow growth

4. Although there's short term instability, it is not projected to affect the continuity of China's high growth.

## **Investment**

### **1. Introduction**

1. Investment rate has increased after big push strategy failed.
  1. Also the investment rate is growing
2. Investment is the top reason for China's high growth
  1. Fixed capital formation becomes a larger and larger part of GDP (30% to now 40%)
  2. Similar to East Asian countries that rely on FDI in the past but unlike them, China has not run into a current account deficit and is not dependent on FDI
  3. Investment is fully funded by domestic savings
  4. Effective because China has a huge pool of labor that can slot into new industries at relatively low cost
3. Investment and growth relationship is fuzzy because although many countries keep investment high, growth rates are not close to predictions
4. Investment is costly as it reduces consumption
5. Investment is subject to LDMR
6. Alternative view is that transfer of technology is the reason
7. China's investments are unique because they are always high regardless of economic conditions due to the government's direct role
  1. Investments never dipped below 25% of GDP even in bad times
  2. Key difference against other economies that died' when GDP fell as investors pulled out
8. China spent 5% consistently on inventory accumulation unlike other countries at 1%
9. After 1990s reform, inventories fell to nothing but instead of swapping to consumption, investors invested even more
10. China's key point is that investment was sustained by gradual increase in productivity of the economy
  1. Backed by confident continual flows of FDI

## **Structural Change: Common Patterns**

1. Increase in output comes from accumulation of physical and human capital
  1. Exiting jobs and upgraded and workers move to more modern sectors (higher productivity)
  2. Modern sectors also have greater potential for even higher productivity
2. Iron Law of development where over time, primary sector employment falls giving way to secondary sector
3. Successful economies don't just see a fall in the agriculture sector but also their agricultural sector modernizes as well
  1. This is important so that the economy is fed agricultural products continuously at low cost
  2. Leads to even more rapid development
4. Secondary sector has no iron law and is more diverse but usually it builds up to about 25% of GDP before falling off.
5. Tertiary sector usually starts building up after GDP hits \$10,000 per capital PPP.
  1. Depends on the level of service the workforce is involved in - low value vs. high value jobs

## **Structural Change in China: Labor**

1. Large labor force of about 740 million in 2000.

2. Ability of the growing modern sector to absorb labor is key determinant of economy's ability to transform itself
3. Figures
  1. 1978: 71% in agriculture showing the underdevelopment and distortions caused by the administrative regime
  2. 1983-1987: Farmers moved to TVEs
  3. 1990s: Urban rural migrations restrictions reduced
  4. 2003: Investment driven acceleration of economy
  5. 2004: First time agriculture falls below 50% of employment
    1. Not good enough though, much transformation still required
4. Periods of high growth are periods of opportunity of rural workers and also the chance of structural change in labor.
5. Some setbacks:
  1. 1996-2002: Movement of workers away from agriculture slowed because SOEs were restructured and there were mass layoffs in such factories.
    1. China also had underemployment at that period.
6. Late developing service sector at only 12% of workforce in service
  1. Caused by background where the socialist government did not invest in service sector and also discriminated against individual service providers
  2. Market expansion expected to cause service sector to expand
    1. Service sector climbed to 30% in 2004.
  3. The government's monopoly over higher skill service sectors including finance related sectors

### **Structural Change in China: GDP**

1. Viewed via changing share of total GDP by measuring GDP in value
  1. Choose price standard and properly handle changing price levels.
  2. Important to do so in China because Big Push strategy distorted prices. Socialist government also followed a high price policy for industrial output causing an overstatement of industry's contribution to GDP.
    1. Prices of agriculture and services thus undervalued.
2. 1978 dominated by industry (48%), agriculture (28%) and service sector (24%)
  1. Price distortions made industrial workers look 7x more productive than agriculture ones
  2. Opening of the market now places industry as lowest inflation but highest growth (negative relationship)
3. Hard to judge GDP due to continuously shifting prices so judge it by constant prices from recent years
  1. China is now seen as a less extreme outlier as it's industry falls to 29% and agriculture 42% in 1978 this time

### **Structural Change & Globalization**

1. High industrial share in 2004 (includes mining, petroleum, utilities)
2. Manufacturing makes up 75% of secondary sector (industrial + construction)
  1. Manufacturing ended up making up 35% of total GDP
3. Ironical that investment and manufacturing only increased after China abandoned the Big Push
4. Globalization's effect is seen as China's manufacturing is large because of global demand
  1. China's is 'the world's factory'
5. Globalization via comparative advantage may cause economies to have unbalanced growth across sectors
  1. India is going all out on services
  2. China all out on manufacturing

### **Conclusion**

1. China's command economy and Big Push strategy had policies restricting labor mobility, controlling prices, neglecting agriculture and services
  1. Caused growth and structural changes to divert from the normal development path
  2. But now it follows the pattern
2. Overall attributes:
  1. Unusually large labor
  2. Highly developed urban cities, underdeveloped rural
3. Structural change will continue.

## **Chapter 12: Rural Industrialization - Township and Village Enterprises**

### **Introduction**

1. Golden age of TVE: 1978-1996
2. Sprout in rural areas where there was less central control
  1. Springboards marketization
3. Brought competition to SOEs
4. Increase rural incomes
5. Absorb rural labor
6. Interesting ownership model
  1. Collectively owned = public owned enterprises
  2. Such ownership dissolved the monopoly of SOEs.
7. Changed nearly every sector of China's economy
8. Dramatic transformation after 1996: Privatization
  1. Most died to more intensive competition and lesser + more expensive credit

### **Origins of TVEs**

1. Household business were important and caused a bottom heavy economy.
  1. Flexible
2. Dense web of markets and sideline operations
3. GLF 1950s Command centric control disrupted the link between growing and processing agricultural products as state took everything.
  1. Household income declined from areas where large portions of income came from sideline activities
  2. Work fell into decay
  3. Dense areas can no longer support its population due to small land
4. Switch to communes during GLF but less developed provinces could not make the switch and manpower drain from agriculture was a disaster
5. CR era made some changes to avoid GLF problems
  1. Movement of workers out of agriculture controlled
  2. Rural industries tied to agricultural collectives and asked to serve agriculture
  3. Interpreted that industry should serve agriculture
  4. Industry was capital intensive and did not absorb the rural labor force (90% of it in agriculture)
  5. Rural industries left outside the plan since it served only a few local customers, not worth integrating
  6. Revenues earned by rural industry channeled by local governments to public works and agriculture support projects
  7. But small dense network of enterprises, common in Asia, was suppressed in China.

### **The Golden Age of TVE Development**

1. 1979 liberalization of rural industries
  1. Relaxation of state monopoly in purchase of agricultural products
  2. Since TVEs were collectives, they are ideologically safe enough for urban industries to subcontract work to.
  3. TVEs handled their own processing and they were now free to engage in whatever activity they could find a market for.
2. TVEs was seen as the path out of poverty, supported by the government.
3. Most dynamic part of economy from 1978-1995.
  1. Employment from 28 million (1978) to 135 million (1996)
  2. 9% annual growth rate



3. TVE value added <6% now >26% even though GDP was already growing rapidly itself.
4. Create competition for SOE and started marketization

### Causes of Rapid Growth

1. TVEs faced factor-price ratios that reflected China's true factor endowment
  1. Big push strategy focused on wrong input (capital). China was labor rich but capital poor.
  2. Government made labor expensive but capital rich
  3. TVEs escaped this problem:
    1. Worker salaries lesser than 60% compared to urban
    2. When cut loose from Maoist Five Small Industries policy, they adapted quickly to available production factors
    3. 9x the ratio of labor to capital as compared to SOEs.
    4. Competitive advantage due to low wages
2. TVEs were able to share in the monopoly rents created for state firms; rural industries were extremely profitable
  1. High profit margin on capital was 32%
  2. Not due only to point 1
  3. Broader network of supporting services and achieving EOScale actually caused profit to decline
  4. Instead they benefited from protected market (that was created for SOEs). They shared the profits from this market with the SOEs.
    1. Early entrants earned the most but supernormal profits fell as more and more entrants came in. (Monopolistic Competition)
  5. They also benefited from empty niches that was not covered by the command economy
    1. Wenzhou's buttons, ribbons and elastic bands met pent up demand
  6. Increase in incomes in rural sector also boosted construction demand
3. The institutional framework surrounding TVEs was favorable to development
  1. Ownership was as a complete whole and local governments had powerful incentives to develop TVEs even though they were not in total control as TVEs were a source of wealth to the local economies
  2. 3 ways of local government support
    1. *Formal taxes were low on rural industry, so money stayed within the rural area*
      1. Rural taxes were low, urban taxes were high
      2. So they enjoyed price policy without needing to pay taxes
      3. But about 30% of profits paid to local governments to support public goods and agriculture
        1. These fees were extra budgetary so the local governments did not have to pay upper governments and often re-invested into TVEs for even more profit
    2. *Local governments acted as guarantors for TVEs, so bank capital was available.*
      1. Other socialist economies had problems accessing capitals but not TVEs
      2. Local governments also pressured banks to provide funds to firms
      3. But TVEs continued to have hard budget constraints - They had to bear the full cost of failures (whole local community) - So more responsible.
        1. Local governments underwrote some risks allowing firms to enter production with a larger size and enjoy EOScale.
    3. *Existing credit institutions were easily adapted to support TVEs*
      1. Take advantage of high household savings that skyrocketed around the same time (1980s)
      2. Borrowing through Rural Credit Cooperatives increased thanks to greater amount of savings
4. Revival of traditional economic ties meant that proximity to urban areas fostered rural industry growth
  1. Rural industries highly concentrated in the coastal areas

1. Cities grew with knock on effect for rural places, providing transportation networks, communications markets, technology and other means to boost productivity
2. Because command economy had cut off links between cities and rural areas, the reconnection caused rapid growth of the TVEs
  1. 60%-80% of rural output sent to Beijing, Shanghai and Tianjin
  2. Facilitated by family relations when rural workers went to cities to work
  3. SOEs also subcontracted work to rural areas as it was a way to cut costs.
    1. Also less regulation and restriction in accessing rural resources like labor
    2. Escape from rigid controls of state sector
5. Organized diversity accommodated growth
  1. TVEs did not have to follow models
  2. Highly adaptable with employee owned co operations
    1. Very different from bureaucratic SOEs.
    2. Adapted to a broad range of opportunities / economic conditions
  3. Many were actually private, inked as collectives to escape political pressure. Private companies are very flexible and mostly profitable
6. Conclusion
  1. Command economy did not touch the TVEs much but actually make them profitable due to the systems placed on other sectors (like tax)
  2. Rural sector became a good ground for organizational experimentation
  3. Entrepreneurial energies of Chinese given ample expression
  4. China's huge size played crucial role, even miniature township economies where huge and there was tons and tons of competition
    1. Competitive climate might have been adequate enough to overcome government control and distortions.

## **Transformations of TVEs in the New Century**

1. Introduction
  1. Massive transformation in mid 1990s
  2. More challenging external environment due to trade
  3. Turned private due to intense competition
2. The Changing Economic Environment of TVEs
  1. National policy moved to building markets and regulatory institutions
  2. Macro emphasis to control inflation and look into financial independence and accountability for banks
  3. Tough environment for TVEs to thrive due to increasing competition
  4. Urban firms forced to move into market niches (that the TVEs had exploited) due to more competition
    1. Ended up TVEs had even more competition
  5. Urban incomes rose and consumers demanded higher quality products than what TVEs could produce. So fall in demand
  6. TVEs stopped absorbing agricultural labor until after 1996 but at a very slow rate
  7. So they are now less special.
3. TVE Restructuring: The Great Privatization
  1. Introduction
    1. Public ownership of TVE interpreted as a result of a uniquely co-operative Chinese culture (only possible at early stage where local actors had to co-operate)
    2. Or as an adaptation to political constraints and insecure property rights
    3. With increased competition and labor mobility, local government increased incentives for TVE managers but local governments became a less important component so TVEs went private

4. National ideological constraints (socialist mindset) also relaxed so... everything went private
2. *National Policy and Local Models*
  1. Taboos against private businesses lifted but local governments get to determine pace of privatization
  2. So locals experimented with privatization with different outcomes and mechanisms:
3. *Market Conditions & Privatization*
  1. TVEs do not usually lay off workers and tried to keep full employment even by under employing workers. Ended up having to lay off some as they moved private
  2. Asian financial crisis made China aware of banking sector's importance. Local government's ability to pressure banks for credit declines. Banks ended up preferring to lend to private firms as private firms have collaterals that can be seized if loans go bad.
  3. TVE managers moved to private because there was more money there. They might have been 'rich' in the past but that's because they were compared to relatively poorer locals. Local leaders told to focus on policy issues and leave running the TVEs to private sector as well
    1. Insider Privatization
4. *Insider Privatization*
  1. Incumbent managers or government officials begin owning large shares of private firms as compared to other board members, workers, etc.
  2. Managers know the firms best and may try to make the firm look worse so it can be purchased at a lower price (when they want to own it)
    1. Possible corruption and plundering of public assets
  3. But such managers often care about their firms and are usually the ones who started the firms in the first place
  4. Because China doesn't want to use the word 'privatization', lines are blurred and so is transparency of ownership and operations
  5. Thus, high variations in the process of privatization and restructuring
5. *Local Variation in Privatization Process*
  1. 3 notable experiments
    1. Joint Stock Co-operatives. Workers allocated purchase rights for shares but not equal, managers can get 20x more. Workers can sell their shares after a year. Shares trading
    2. Or government retain stake in firm trying to operate joint venture with new manager. Makes it hard to tell if the firm is actually private
    3. Or privatization without a tail. Local governments give soon-to-be private buyers a choice between buying out the entire TVE at a high price or at a low price but pay government a share of profits for the next 5-10 years. So if the buyer feels that profits will be high, he will buy it out (so that's without a tail-profits tax). This is actually the preferred manner of purchase

### **Emergence of New Forms of Rural Industry in the 21st Century**

1. Not just limited to privatization
2. Weaker ties to government
3. TVE markets are more and more interregional
4. Turning from being close to cities to becoming like cities (densely populated with road networks)
5. Emergence of highly competitive industrial clusters
  1. High number of small firms contributing to single specialized product
  2. All firms are competing against each other maximizing the MPL and MPK in narrow activities

3. Markets help to balance between flexibility and long term co-operation between firms
4. Such clusters also have appeared in Brazil and Italy

## **Chapter 13: Industry: Ownership and Governance**

### **Introduction**

1. Industrial revolution since 1978
2. Industry has grown at a real annual rate of 15% since 1980
3. Institutional change the main cause of this, movement away from command economy sparked it

### **Ownership Change: A Diverse Industrial Base**

#### **1. Introduction**

1. Privatization had nearly no role in early stage (1978-1993)
2. TVEs were the main guys who entered the market and drove competition and caused ownership changes
3. Ownership has 2 components
  1. Right to Income
    1. Part of income depends on asset owned
    2. Residual income only as you've to pay off all outside parties based on contracts
  2. Right to Control
    1. Same as above, depends on your share of assets
    2. Owner of asset can decide to do whatever he wants with it after all contractual obligations are fulfilled

#### **2. Ownership Change in First Period of Transition (1978)**

1. SOEs began as the big fish in the industry, producing 77% of industrial output.
  1. Managers had many targets to meet including welfare, health and political indoctrination and anything the bureaucracy says
  2. Not much risk involved, nothing new
2. TVEs entered without the obligations that SOEs faced
  1. TVEs ate the share of the industries till 1996
3. Small scale sector companies emerged as the authorities were content to let them independently develop
  1. But they could not grow due to lack of property rights
  2. Also faced discrimination
4. Government, Collectives & Private formed the tripod industrial sector in a gradualist industrial transition
  1. More diverse ownership
  2. More market growth
  3. But continual government control

#### **3. Ownership Change from 1996 through Present**

1. Company Law put in place in 1994 to provide legal framework on what ownership forms are allowed
  1. Framework for 'corporatizing' SOEs
2. SOEs could sell shares to start moving into a hybrid ownership
  1. Blurred the lines of ownership
  2. Such changes still being worked out till today
3. Reorganization of ownership overshadowed by downsizing of SOEs
  1. Policy makers grasped only the large firms to restructure and make them more competitive; and allowed the small firms to go into the hands of the local governments to decide how to restructure them
    1. Dramatic difference in which the two paths led to.
    2. Central government held firms were large, profitable and had monopoly over energy and natural resources

3. Local government firms were small and very exposed to competition (thus low profits)
4. SOEs began joint ownerships by selling shares but remained under government control
5. Collectives changed more drastically moving into privatization quicker and so collectives began disappearing into private firms
6. Foreign invested firms gained importance but not much, moderate pace.
7. Statistical data at this point is not accurate due to blurring of ownerships and selective recording of firms that are 'above-scale'
8. Select group of huge firms moved from control of government to control by State Asset Supervision and Administration Commission (SASAC).
  1. Central SASAC held onto small number of firms that held key roles in key areas such as energy, telecommunication and military sectors
  2. Local SASACs set up in provincial level as well
    1. Small scale industry important but trends unclear
      1. Grew quickly due to privatization and liberalization
      2. But fell around year 2000 due to intense market competition
    2. New data suggest apparent trend that small private firms are growing up to become large firms (above-scale size)
9. Remaining SOEs (capital intensive) accounted still for a large industrial output but low labor employment.

## **Chapter 14: Structural Change - Industry, Energy and Infrastructure**

### **Introduction**

1. Growth in Chinese economy, especially the industrial sector has led to increased demands for energy needs
2. Important for China to continue growing but with efficient use of energy

### **Growth and Structural Change in Manufacturing**

#### **1. Introduction**

1. 1949-1978: Focus was only on basic industrial materials (Metals and machinery)
  1. But the technology of China's machinery output was lagging behind still
  2. Extremely capital and energy intensive (not efficient)
2. Post 1978: China focused on labor intensive low technology sectors.
  1. Needed little fixed investments
  2. Niche goods for niche markets (buttons and threads)
  3. China's distortion of usual sectoral linkages and structural progresses mean that when the light and textile industries declined in 1978, it was not that China had got past the primary sector, it had actually only begun.
    1. Didn't move upstream, started 'payback' or revisiting old neglected sectors
    2. Light and labor intensive industries began growing (electronics, communications, furniture, plastic products)
      1. These sectors are areas that produce more custom based
    3. Old traditional sectors like metal and energy declined
  4. Open to foreign trade also created new industrial opportunities that were labor intensive in nature
3. Post 1995: New patterns of structure change
  1. Overall shift to light diversified manufactures ended in 1995
  2. New industries that employed higher technologies emerged and grew (electronics and telecommunications)
  3. Industrial deepening finally occurred, several old energy sectors begin growing again (remember: downstream)

#### **2. Regional Growth Patterns**

1. Strong relationship between regional growth patterns and structural change patterns
2. Coastal grew quicker again as they are best positioned to take advantage of policy changes
  1. Engage foreign trade, attract foreign investment, absorb world technologies
  2. They were better endowed with skills and infrastructure
3. Coastal were also experienced with labor intensive firms and so new firms of that nature came in quickly
4. As much as coastal benefited, northeast were on the other end
  1. Disadvantaged by early specialization in heavy raw material industries
  2. Now have obsolete factories and depleted resources
  3. Did not benefit from entry of small scale firms
  4. Dropped in share of national output from 16.1% to 8.6%