

The Development of China's Economic Reform

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Since the 8th National Congress of Communist Party of China (hereafter referred to as CPC) held in September 1956, on which the reform of the “economic management system” was decided, China’s economic reform has been going on for nearly half a century. At the beginning, the so-called “reform of the economic management system” was only limited to some policy adjustments so as to improve the economic situation and vitalize the economy, but there was not a certain fixed goal. But the reform with market orientation has been becoming more and more clear-cut until mid 1980s. In the reform lasting for 50 years, China has been taking various measures to reform the original economic system. (1) 1958-1978, Administrative Decentralization: this period was featured by the central government distributing its power and benefits to the government at different levels. (2) 1979-1992: Incremental Reform: also entitled “priority of reform for outside system sectors”, the reform was carried out mainly in non state-owned sectors or those sectors outside the plan so as to facilitate their development. (3) 1993-2002, a strategy was adopted that the reform shall be advanced integrally and there should be breakthroughs in key sectors. This reform intended to initially establish socialist market economy. (4) After 2003: a scientific development view has been put forward, and the reform has been carried out in economy, society and politics so as to improve the socialist market economic system.

1. Historical background: The forming of centrally planned economic system and the successes in economic development

Before the founding of the People’s Republic of China in 1949, China was like an extremely poor and weak giant. It claimed a population of 0.5 billion on a vast territory of 9.6 million square kilometers, while the highest annual outputs for the main industrial products were meager – yarn 0.445 million tons, fabric 2.79 billion meters, coal 61.88 million tons and electric power 6 billion Kwh. The highest annual crop output had been only 0.15 billion tons and cotton 0.849 million tons. This was the starting point of new China’s economic development. After three years of economic reconstruction (1949-1952), a socialistic

transformation was launched to settle all the ownership problems, and the socialistic ownership of the means of production became the only economic foundation of the nation and the society. By the end of 1956, the transformation had been basically completed, and a public ownership was established, which was mainly based on two forms – the first being state owned system and the second being quasi state-ownership system, i.e. collective ownership system. Based on these, a Soviet style centrally planned economic system was established. From 1953 to 1957, the First-Five year plan was fulfilled.

During economy recovering period (1949-1952), the government enacted a series of effective economic policies to control the galloping inflation, restore the production that had been destroyed in the wars and increase the employment. At the same time, it continued with the land reform, which had been started by the communist government since the period of “Base Area Era”, so that “Every farmer has his own land”. The privileges enjoyed by the imperialist countries were abrogated, and the bureaucratic capital was confiscated. By 1952, the outputs of most major agricultural and industrial products had surpassed the highest level before the founding of the Republic, the inflation was kept within limits, and the people began to live and work in peace and contentment. During the period of “Socialist Industrial and Commercial Transformation” (1953-1956) and the period of the First Five Year plan (1953-1957), the original national industry and commerce experienced a transition to socialist economic models through a series of policies like state capitalistic form. The farmers getting the land organized themselves spontaneously so as to cooperate with each other in farming. 156 key projects were constructed to fill up the blanks in the national economy, and the throughput of the weak sectors was strengthened. During this period, the national economy developed steadily, the proportion between different industries was in balance, the average annual growth rate of National Income achieved 8.9%, and the average annual consumption of the urban and rural residents increased by 4.2%.

From the economic development strategy point of view, the centrally planned economic system was based on the economic development strategy, which put priority to heavy industry, aiming to quickly change the poor and backward situation in China. Taking this background into consideration, the traditional economic system consisted of three parts. The first was the contorted price system. When the economy is underdeveloped and capital is extremely scarce, the capital cost will be very high. If the relation between demand and supply decides about the interest rate on the capital market, the strategy to primarily develop the capital-intensive heavy industry would be very difficult to realize.

Therefore, reducing the cost of heavy industry is only feasible through lower prices of capital, foreign exchange, energy, raw materials, labor force, life necessities, etc. Second is the highly centralized planned system for resources allocation. The contorted production factors and product price system caused the shortage in economy. In order to distribute the resources to heavy industry, a new resources allocation system different from the market mechanism must be set up. Therefore, the following systems, including banking, foreign exchange management, material allocation and labor income, etc. were featured by highly centralized planning control. Third, there was a management system with lack of autonomy at micro-operating level. In such a situation the government must ensure that the surplus products should be used by the micro-operating organization according to the strategic goal. Therefore, it nationalized the industry and reconstructed the agricultural sectors in people's communes, so as to set up a micro-operating system applicable to the development strategy of heavy industry. These three parts were dependent on each other and they constituted an integral organism.

China's government initiatively adopted a development strategy that put priority to heavy industry and the centrally planned economy. China made this choice due to the international environment it faced and its goal to quickly achieve industrialization. It may also be attributed to many domestic and international factors of this time. The main features: (1). It took the theory of traditional socialist economy from the political-economical textbooks of the Soviet Union, copied Marx's early conjecture about socialist economy, and regarded "distribution according to work", "public ownership", "planned economy" as the basic characteristics of socialist economy. On the other hand, it ignored the principle of material benefits and did not accept the practice of co-existence of multi-economic elements and market economy. This philosophy was the theoretical basis for setting up the centrally planned economy. (2) After the Korean War broke out in 1950, China was up against the pressure and blockage from the western countries, and as a result, strengthening the defense power had to be considered as premier. China had to choose such a system and arrangement, which allowed mobilization and allocating of the limited resources in favor of heavy industry with national defense as a core. (3) Past one hundred years of history humiliated China as a colony and half colony, Chinese government and people universally had a strong wish to overtake the western developed countries. It was thought that China would achieve the modernization in a very short period of time, if it could depend on the state power already obtained, fully mobilize, allocate and use manpower, material and fund with the

Soviet Union as an example. (4) For quite a long time, China had been a nation of petty farmers, and “administrative power governs the society” had historically been an established and consolidated tradition. After liberation, with the high prestige it enjoyed during the long-term revolution, the CPC established an all-around government under its leadership. This was the political foundation on which China could carry out the socialist transformation and establish a planned economy within only a very short period of time.

2. Decentralization: The reform and adjustment within the planned system (1958—1978)

The highly centralized planning economic system enjoyed advantages of a command economy – it could mobilize the resources to an extremely high extent, and use them in the key infrastructure projects to which the government paid close attention, so that the industrialization of heavy industry and the defense industry could be carried out quickly. However, Chinese leaders found some defects to be removed soon after the establishment of this system. The main defect was that “The power is centralized too much to the central government”, and the central government gave too much administration and directions, which caused lack of flexibility. At that time, delegation of greater power and benefits to the enterprises and their employees was considered not to conform to the requirement of “keeping a politically correct stand”, so that the system reform was defined as “transferring system (power) to a lower level”. Therefore, the basic measure taken was that the central government transferred power to governments at lower levels. That was the idea of “administrative power distribution”. According to this idea, China started its first economic reform in 1958 since its establishment of socialist economy. The focus of this reform was the power and benefit distribution among governments at different levels. It allowed the delegation of power over the industrial management, commercial management, fiscal management to the local administrative organizations, so that the local governments and the enterprises could give full play to their initiative and enthusiasm to fulfill the plan set down by the state in the light of the local conditions. The powers transferred covered the following – planning, enterprise jurisdiction, resources allocation, infrastructure construction project approval, investment and credit management, fiscal levy, and labor management. Moreover, some other measures were also taken to a limited extent to transfer power to enterprises. These measures ranged from reducing planned quota, enacting a regulation of “profit retention system”, increasing the power of enterprise over

human resources management. In addition, enterprises could regulate some fund, and were entitled to increase, reduce fixed assets and even claim fixed asset depleted or written-off.

The planned economy allocated the resources with administration commands – with this general frame keeping unchanged, powers were transferred to governments at different levels. This practice, together with the people's communes in rural China consisted of the system basis of "Great Leap Forward". With support of this system, local governments substituted scientific attitude with administrative commands, and they made full use of their power to mobilize resources to approve many infrastructure projects, recruit new employees, mobilize farmers' resources free, so that they could meet the planned quota that were not based on reality at all. As a result, different districts, departments and working units worked in their own ways, and each was independent of other organizations. They had to scramble for the resources, which destroyed the normal order of economic development, and the proportion of national economy was in serious imbalance. The abnormal development of heavy industry was the most obvious evidence. From 1958 to 1960, heavy industry increased by 230%, much higher than the growth rate of the light industry development, which was only 47%. At the same time, agriculture declined by 22.8%. Such a high accumulation rate made the residents' living standard decline annually by 4.9%, and fiscal deficit increased considerably. In rural sector, the establishment of people's communes was against farmers' wishes, and these communes were not based on the free will of cooperative economy. Peasants' enthusiasm was greatly damped. In addition, production was declining, a lot of factories and commercial enterprises suffered losses, living necessities were in short supply, and the economy as a whole was in great difficulties. Finally, when the natural disaster occurred, production dropped dramatically and great famine occurred in very large areas. A lot of urban residents suffered from edema due to lack of food; and in rural areas, thousands of people died from famine.

In 1961, the state was forced to make adjustments to the national economy, and decisive measures had to be taken to get over the serious economic difficulties caused by the "Great Leap Forward" and "Anti-Rightists Movement". Power in finance, credit and enterprise jurisdiction were centralized again, and a system was set up, which was "more strict and tight" than that of 1950s. Most enterprises transferred to the local governments were administrated by the central government again. The investment in infrastructure was cut down, the development of heavy industry was put under control, and the imbalanced industrial structure was readjusted. In rural areas, the working units were made

smaller with the production brigade as the basic working unit. After several years, economy was slowly recovering, and in 1963 it basically recovered. Agriculture, light industry and heavy industry were developing in a balanced way. Outputs of major agricultural production achieved or surpassed that of 1957. In contrast with 1960, the output value of agriculture increased by 42.2% in 1965; the output value of light industry increased by 27.5%; heavy industry decreased by 37.2%. The national financial situation became better, the accumulation rate was lower, and people's living standard got improved. Compared with the period from 1958 to 1960, the average accumulation rate fell by more than 50% during the period from 1961 to 1965; moreover, the actual consumption increased by 25.7% in the first five years of 1960s in rural and urban areas.

However, when the economy began to develop normally, all the disadvantages of planned economy appeared again. In addition, in the "Cultural Revolution"(1966-1976), economy, society and political life were in anarchy. The production development of industry and agriculture was ruined, industrial structure was in serious imbalance, the incentive of employees was restrained, the productivity was not improved, the living standard of rural and urban residents was improved only a little, the salary of the employees in state owned enterprises (hereafter referred to as SOE) had been declining, and income of peasants remained the same as before. During this period, the decentralization of the administrative power similar to that of 1958 had been put into practice. For instance, the largest reform - the economy management system reform in 1970 - was labeled by the slogan "Power decentralization is revolution, the more power is delegated, the more revolutionary it is". However, till the end of the "Cultural Revolution" in 1976, due to the ideological barrier that socialism could only allocate resources in accordance with administrative commands, the market-oriented reform could hardly be accepted politically. As a result, transferring the planning power to local governments became the only possible choice available to such reform.

After the Cultural Revolution was over (1976), within two years the government tried to correct the mistakes made in the past 10 years so that the normal economic order could be resumed. However, because the low-efficiency economic system had not been reformed, and the established development goal was not applicable to the national situation, the accumulation rate continued going up, which made the economic situation worse, and the industrial structure became even more seriously imbalanced. By 1978, most economic problems had not been resolved, and 250 million peasants were extremely impoverished. On the whole, all the decentralization reforms during 1958-1978 failed, because they

caused chaos without exception and then the power had to be centralized again. “If power is transferred, there is chaos; if the power is taken back by the central government, ossification occurs.” A circulation like this formed “Power decentralization--chaos--power withdrawal--ossification”.

3. Incremental reform: rural reform, development of non-state-owned economy, experimentation of opening to the outside world and dual track approach. (1979-1992)

After the Third Plenary Session of the 11th Central Committee of the Communist Party of China (thereafter referred to as the Third Plenum) held in late 1978, China started its economic reform in a real sense. However, at the beginning of the economic reform, the government did not have an overall outline. The reform was carried out “step by step”, starting from the production units at the basic level. At that time, aiming at the serious situation of low incentive and low efficiency in people’s communes and SOEs, contract responsibility system with remuneration linked to the household was put into practice in rural areas, also experiments were made to give more autonomy in some SOEs. The rural reform was quite successful, and efficiency in SOEs was improved to some extent. Then in the mid 1980s, an overall reform was carried out in urban areas. Since then on, reform had started in fields such as price, taxation, revenue, fiscal administration, finance, employment and welfare etc.

3.1. Explorations of enterprise reform

Enterprise reform started from the enterprise’s autonomy. At the end of 1978, Sichuan province began to “expand enterprises’ autonomy” so that the enterprises could enjoy more power and get more profit, and it was a success. By the late half of 1979, the State Council successively issued several documents concerning reform of SOEs, requiring all the districts and departments to carry out the experiment of expanding autonomy in some chosen enterprises in accordance with these regulations. By 1980, the outputs of chosen pilot SOEs accounted for 60% of the national industrial budgetary output, profit being 70% that of all the industrial enterprises. In the first several months, “autonomy” considerably improved incentive of the enterprise employees to increase output and profit. However, the limitations of this practice soon appeared. In the new system, some enterprises with autonomy were not bound by the fair competition on the market, neither were they guided by the price system that could reflect the extent