



## CHINA'S ECONOMIC REFORMS

*Although often held to be the last remaining large socialist country, China has abandoned many features of the command economy. It also has one of the fastest growing economies in the world: in 1992, economic growth reached 12 per cent. Much of this growth performance appears to be the direct product of the economic reforms over the fourteen years since 1979 when China also initiated new policies of opening up to the outside world. This Briefing Paper analyses the content of economic reforms, indicates some of the problems encountered in the reform process and traces the impact on incomes and income distribution.*

### Economic Performance

Originally, China's reforms were targeted to achieve a doubling of real GNP in the decade of the 1980s, with a further doubling in the 1990s, so that by the end of the century, China's real GNP would have quadrupled. In fact, real GNP grew at an annual rate of 9% in the 1980s, and the doubling target was reached three years early, in 1987. It was then calculated that with an annual rate of growth of 8-9%, the quadrupling target could be achieved in 1994 or 1995. By the end of the century, therefore, real GNP is expected to equal that of some major industrial countries such as the UK, Italy or France.

The reform process has been remarkably successful. It consists of six main components:

- the introduction of private farming under the 'household responsibility' system
- encouraging private business
- restructuring public enterprises
- promoting foreign trade
- policies to stimulate external financing
- decentralising administration to the provincial and local level.

### Household Responsibility

The reforms began in the rural areas where a contract-based system with household responsibility replaced the people's communes. Peasants acquired the right to manage their own land and the practice of unified procurement, with production allocated among farms, ceased. Price control over the majority of farm products was liberalised and this enabled the agricultural sector to develop rapidly in the direction of specialisation and commercialisation. Aggregate output increased. For example, grain production has increased steadily from 305 million tons in 1978; 320m tons in 1980; 446m tons in 1990; to 435m tons in 1991. The output of cotton increased from 2.7m tons in 1980 to 5.67m tons in 1991; of oil-bearing crops from 7.69m tons in 1980 to 16.38m tons in 1991; and of cured tobacco from 0.72m tons in 1980 to 2.67m tons in 1991.

The household responsibility system has stimulated production increases and enhanced agriculture incomes (see below), but it has its limitations, particularly in consolidating the small family farm as a unit of production in a country of severe scarcity of cultivable land and where some flexibility has been permitted in the implementation of the 'one-child per family' policy in the rural areas, leading to some increase in rural population growth rates.

The main policy response to the growing partition of surplus

rural labour has been the development of village and small town enterprises which employed about 100 million in 1991, accounting for 23% of the total rural labour force. The proportion of total rural output from such enterprises rose from 26% in 1980 to 59% in 1991. By allowing the peasants to 'leave the land but not the rural area', China has attempted to prevent labour migration to the large cities.

### Private Ownership

One of the main tasks of the economic reforms is to transform China from a single public ownership economy to one with a dominance of public ownership co-existing with various other forms of ownership. As a result, the public sector is declining while the private sector in various forms is growing. During the period 1978-90, the public sector's share of GNP decreased from 98% to 93%, while that of the private sector increased from 2% to 7%.

Table 2 shows the related fall in the share of state-owned enterprises in respect of both industrial output and retail sales during the 1980s. In industry, at least, collective ownership has also surged, but in retail sales the recent rise in private and individual ownership is particularly striking.

Although the private sector still accounts for only a minor proportion of total industrial output, and most private-sector enterprises are small, a few larger companies are emerging, for example, the Nan-De Economic Group. The President of Nan-De, Qi-Zhong Mou, was a high school teacher in the 1970s, and began to run a few firms only in the early 1980s. Now, his 'Nan-De' contains more than 40 firms, has an annual turnover of some 600m Yuan (US\$100m).

### Restructuring Enterprises

Within the public sector the most important change is the removal of enterprise management from government intervention by decentralising decision-making from the state to the enterprise. In 1984, the State Council promulgated 'regulations', authorising state-owned enterprises to make their own decisions on production, sales, and management. However, not all the powers authorised by the regulations have been fully implemented and during the three years of retrenchment, 1989-91, China had to restore some government controls in order to combat inflationary pressures.

Several problems have emerged in the removal of enterprises from government intervention.

- First, the government requires that the party organisation remain active in an enterprise even after the enterprise's removal from government intervention. The issue is how to define the relationship between management and party committee within an enterprise, or rather how to define the roles and functions of the managing director and the party secretary. As a rule, the managing director is required to be fully responsible for managing the business of the firm, for all transactions and contracts as well as for its profits and losses, while the party secretary is in charge of supervising and supporting management. In fact, the party secretary is always more powerful and influential than the manager. Some documents

**Table 1: Growth rate of some major economic indicators (%)**

Year	Population	GNP	Industrial Output	Currency in Circulation	Overall Retail Price	Per Capita GNP
1980	1.18	7.9	9.27	29.3	6.0	6.5
1981	1.45	4.4	4.29	14.5	2.4	3.1
1982	1.57	8.8	7.82	10.8	1.9	7.2
1983	1.33	10.4	11.19	20.6	1.5	8.8
1984	1.31	14.7	16.28	49.5	2.8	13.2
1985	1.42	12.8	21.39	24.7	8.8	11.3
1986	1.56	8.1	11.67	23.3	6.0	6.6
1987	1.66	10.9	17.69	19.4	7.3	9.1
1988	1.57	11.3	20.79	46.7	18.5	9.5
1989	1.50	4.4	8.54	9.8	17.8	2.8
1990	1.44	4.1	7.76	23.9	2.1	2.5
1991	1.30	7.7	14.52	20.2	2.9	6.3

Sources: *China's Economic Year-Book; Statistical Year-Book of China*

**Table 2: Patterns of Ownership in Industry and Commerce**

	State ownership	Collective ownership	Private and other ownership
<b>Industrial output (%)</b>			
1980	76	23	1
1990	56	35	9
<b>Retail sales (%)</b>			
1980	51	45	4
1990	39	34	27

describe the role and function of the senior manager as 'the centre' of the enterprise, and that of secretary as 'the core' of the enterprise. The problem remains how to distinguish 'the centre' from 'the core'. Some enterprises have tried having one person concurrently in charge as 'manager' and 'party secretary'. These experiments indicated that such a dual position made it unable to concentrate entirely on management. The issue of how to define the roles and functions of manager and party secretary at the enterprise level, even after the removal of government intervention, remains to be solved.

- Second, enterprise reform is not always supported by reform in other fields, in particular price reform. In the 1980s, price reform emphasised the raising of prices of certain products (for example, farm products, minerals and other industrial raw materials, transport and other services) in order to improve the price structure. More recently, it has been further deepened, with more emphasis on market forces in pricing and resource allocation. The proportion of administered prices in total retail sales dropped from 97% in 1979 to 23% in 1991, but there is still a long way to go in shifting price determination and resource allocation from planning to the market place. A number of enterprises (in particular coal, power supply and transport) still suffer losses owing to price distortions and therefore rely on subsidies. As elsewhere in the world, the issue of co-ordinating enterprise and price reforms remains a challenge.
- Third, enterprise reform presents problems for social security. It is difficult for enterprises to implement their decision-making power in hiring and firing without the establishment of unemployment insurance, job retraining programmes and job information services. In addition, all levels of government are attempting to reform the pension system. Enterprises cannot be expected to take care of everything (from kindergarten, through housing, health care, education and pensions) for every

employee as they did before. Where some provincial governments are keen on setting up a pension system within their own region, this has led to big differences in contributions and benefits, and produced new obstacles to labour mobility.

### Foreign Trade Promotion

China has implemented its economic policies of opening to the outside world through increased foreign trade and the utilisation of foreign capital. Since 1979, China's foreign trade has grown more than fourfold (see Table 3).

Although trade was often in deficit in the 1980s, there was a declining trend, and in recent years it has begun to show a continuing surplus. One main reason has been the need to compensate for internal market contractions, obliging enterprises to both promote exports and slow down imports. But another important recent reason for the rapid growth of foreign trade is the implementation since January 1991 of a new management system in China's foreign trading companies. This has a) cancelled regional discriminatory and preferential policies (exports and imports, whether in the special economic zones, the open coastal open cities or the interior, all now enjoy the same treatment) and b) abolished various financial subsidies, making firms engaged in foreign trade responsible for their own profits and losses. This reform has given considerable impetus to trading firms. The value of China's exports is now almost 20% of recorded GNP and has surpassed that of many developed countries. Local economists hold that because of the distortion in calculating China's exchange rate, such a high figure is exaggerated and 8% is more realistic. Even so, it still demonstrates that China's economy has already become closely integrated into the world economy (see Box), to the extent that what the USA alleges to be its US\$18bn trade deficit with China has come to be a matter of considerable friction.

### The Role of External Capital

Two kinds of external capital feature here: foreign debt and foreign direct investment (FDI). Of the US\$66bn of external capital utilised by China in the period 1979-91, foreign debt

**Table 3: Foreign Trade (US\$bn)**

Year	1979	1986	1990	1991
Total	29.33	73.85	115.44	135.70
Export	13.66	30.94	62.09	71.91
Import	15.67	42.90	53.35	63.79
Balance	-2.01	-11.96	8.75	8.12



## China and the GATT

China is one of the original contracting parties to the GATT, although it broke off contacts with GATT for more than 40 years. Since introducing the policies of reform and opening in 1979, China's foreign trade has developed rapidly with GATT members.

In order to enjoy multilateral most-favoured nation treatment (MFN), the generalised system of preferences (GSP), and the achievements of GATT in the last several decades in reducing trade barriers and promoting free trade, China submitted its official application to resume its membership in July 1986. Other countries have expressed hopes that China will re-enter GATT in the near future and the first deliberations on its foreign trade system were completed in February 1992 and the negotiation on tariff concessions in October 1992. China could be set to resume its membership of GATT in 1993 whether or not the Uruguay Round negotiations are concluded. US support for China's resumed membership is crucial. China insists its MFN status must be without conditions.

In order to fulfil GATT obligations, China has committed itself to reducing its general tariff level by 5% within 3-5 years and also to reducing non-tariff barriers. This will force most industrial enterprises in China to face keen competition from abroad, especially in those commodities which used to enjoy high tariff protection, such as automobiles, electrical products, chemical products and high-quality textiles. It will force China to speed up its reform of the foreign trade system, the price system, the enterprise system and the financial system, pushing it to link its economy further with the outside world in terms of management, regulations and laws.

amounted to US\$47bn, (70%) and FDI to US\$19bn (30%).

China's *foreign debt* has grown threefold since 1985, and reached US\$60.7bn in 1992. Before 1985, official credit accounted for 50% of medium- and long-term debt; since then, this figure has come down to 30%, while commercial loans have increased to 70%. The repayment of principal and the payment of interest on loans now amounts to US\$8.5bn a year. Because of the improvement in its capacity to earn foreign exchange through exports, China's ability to meet its debt payments is strong. In 1991, the external debt service ratio was 12%.

Since the law on Chinese-Foreign Joint Ventures was promulgated in June 1979, the scale of *foreign direct investment* has expanded (see Table 4). China has brought in policies preferential to foreign investment: for example, the corporation tax rate for China's state-owned enterprises is 55%, whereas that for foreign enterprises is only 33%. In 1989, many western industrialised countries applied economic sanctions against China, but overseas FDI to China continued to rise.

The sectoral breakdown is significant. During the period 58.5% of cumulative total FDI was invested in manufacturing industries, 22.2% in real estate 4.2% in commerce and services, with only 2.8% in agriculture, 1.8% in construction, and 1.2% in communications and transportation. Investing more than half the FDI in industry has played a major role in the development of manufactured goods for export. Investment in infrastructure, mining, raw materials, communication and transportation is small, and this has created some imbalance between manufacturing industry and basic industry and infrastructure.

The development of foreign trade and the utilisation of foreign capital have underpinned the economic reforms nonetheless, further promoting the open policy. Since early 1992, China has rejected an open policy at all levels and has said it will adopt a 'four alongs' strategy: *along the seashore, along the Yangtze river, along the border and along the railway.*

- The *seashore* strategy refers to the establishment of a littoral open zone from the North: the city of Dalian, to the South: Guangdong and Hainan provinces, areas which have grown to be the most active and the strongest economic regions in the country. The other 'alongs' are less categorical:
- The *river* strategy aims to open up twelve cities on the banks of the Yangtze River.
- The *border* strategy aims gradually to open the border cities and actively develop trade and economic co-operation with neighbouring countries – especially the central Asian republics.
- The *railway* strategy aims to open up of the belt along the 'Euro-Asian continental bridge', in particular the less developed northwestern regions.

Nevertheless, the area of open regions been greatly enlarged and incentives have also been adopted to encourage foreign capital to extend into the fields of high and new technology industries and the tertiary sector, such as real estate, commerce and trade, finance and insurance.

## Decentralising Government

In the 1980s, China carried out a programme of administrative decentralisation which shifted economic powers from central to provincial administration and below. In particular, the implementation of a new fiscal system of 'contracted revenue' led to the proportion of central revenue in GNP dropping from 23.3% in 1980 to 17% in 1991 and the share of the central budget in total fiscal revenue dropping from 64% to 48%. The administrative decentralisation has been conducive not only to accelerating the development of some coastal provincial economies, but also to keeping up local enthusiasm for the economic reforms. However, one consequence of administrative decentralisation has been local economic separatism or protectionism. Some examples:

- Local governments have competed to expand the scale of their investment in order to achieve as high a growth rate as possible, regardless of the consequences for the macroeconomy. They have often been sufficiently powerful and influential to be able to instruct the local banks to finance local construction projects by issuing loans, since the banking system has not yet become independent of the government. The propensity to expand, which is inherent in administrative decentralisation, could be the main reason for the high inflation in 1984 and 1988. In 1992 the overheating of the economy was again mainly caused by the expansion of local investment, although the central government took preventative measures, thereby avoiding a new round of high inflation. However, Central Bank Governor Li Guxian was quoted on 1 February 1993 as saying 'By no means will we implement a tight monetary policy.'

**Table 4: Foreign Direct Investment by Source, 1979-90 and 1991**

Regions	1979-1990		1991	
	Contracted investment (US\$ billion)	share (%)	Contracted investment (US\$ billion)	share (%)
Hong Kong and Macao	25.06	62.1	7.51	62.6
USA	4.46	11.1	0.54	4.6
Japan	3.10	7.7	0.81	6.8
Taiwan	2.04	5.1	1.39	11.6
Singapore	0.74	1.8	0.15	1.3
UK	0.60	1.5	0.13	1.1
Germany	0.53	1.3	0.56	4.7
Australia	0.30	0.7	0.04	0.4
Canada	0.29	0.7	0.03	0.3
Italy	0.21	0.5	0.02	0.1

- The local authorities have usually paid greater attention to short-term benefits. They have been eager to invest in processing industries with a high profit and a quick return on capital rather than in basic industries and infrastructure construction, thus intensifying the imbalance of the industrial structure.
- In the late 1980s, some local authorities introduced local protectionism. In order to develop local industries, they broke off the traditional economic connections between regions in order to protect local markets through reciprocal blockades and other trade barriers. The normal circulation of commodities was obstructed and led to so-called 'Silkworm Cocoon Wars', 'Tea Wars', and so on. The negative effects of this local separatism were severe and have not yet completely disappeared.

## Changes in Income and Income Distribution

Living standards have risen rapidly over the past 14 years. Taking 1979 as the base period for per capita income, the income index for 1985 and 1990 at constant prices would be 160.8 and 230.8 respectively.

It is very difficult to do an internationally comparative study of China's per capita income or per capita GNP. World Bank statistics show that China's per capita GNP was US\$410 in 1976, but about US\$380 in 1990-1991: correspondingly, its current per capita income is lower than it was before 1979, if the figures are expressed in US dollars rather than China's currency, the yuan. However, the yuan depreciation from US\$1.7 before 1979 to \$6.0 now does not affect domestic incomes in the way it would a small poor export- or debt-dependent developing country. Instead, a rise in income over the past 14 years has been measured through improved consumption, both quantitatively and qualitatively. The index of per capita consumption, taking 1978 as base period 100, was 176.1 for 1985 and 208.4 for 1990; per capita consumption increased at an annual rate of 6.3% during this period. By the end of 1989, the possession of major durable consumer goods by every 100 households in the urban areas was as follows: camera 16.03, tape recorder 66.96, colour TV set 51.47, washing machine 76.21, and refrigerator 36.47. Some scholars outside China estimated that China's per capita annual income at the beginning of the 1990s reached US\$1,100, though this might be overstated since China still has 74% of its population living in rural areas where the level of income and consumption is still low, and 9% of its population living in absolute poverty.

During 1978-86, significant economic progress, in particular the rapid growth in the rural economy, led to a reduction in absolute poverty in China. It is estimated that the number of people in absolute poverty decreased from 270 million in 1978 to around 100 million in 1985. However, no further progress in reducing poverty appeared to be achieved during 1986-90. By the end of the 1980s those living in absolute poverty still accounted for 9% of the total population, or almost the same ratio as before. Most of the poor were concentrated in the rural areas (especially in the remote border areas and interior hilly areas); their education and health also remained poor.

The stagnation in alleviating poverty during the period 1985-90 is largely attributable to the rise in prices of agricultural products. This caused the economic status of the poor living in the remote border areas and the hilly interior to deteriorate further since these areas are deficient in resources and most poor people are net purchasers of grain and other subsistence foods.

China's economic reforms and its economic development have also led to some significant changes in income distribution. One source of change has been the dual price system (a co-existence of market pricing and planned pricing). It is estimated that these price differences amounted to 357bn Yuan in 1988, or 30 per cent of national income. Commodity price difference accounted for 150bn Yuan; there were 113.9bn Yuan interest rate differentials between the formal and informal credit markets, and 93bn Yuan differentials between the official exchange rate and the black market rate. Effectively, 30% of national income leaked out from the chinks between the planned price system and the market price system. This leakage has enhanced income inequity and also encouraged corruption.

## Initiatives on Poverty

The government is conscious that poverty alleviation lost its momentum in the late 1980s. Under the new Eight Year Plan (1991-8), two major poverty-alleviation initiatives have been introduced: (i) to extend assistance to the poorest of the poor in the worst physical environments and (ii) to integrate production, education, health, family planning and transport programmes into comprehensive packages involving the local governments.

The Regional Department of the State Planning Commission has initiated a Food-for-Work Programme which assists with the building of roads and river transport, irrigation works and other capital construction in the poor areas. All the central ministries and agencies as well as the provincial authorities have their own poverty-alleviation programmes and projects. The Agricultural Bank of China and other banks offer concessional loans for regional developments. In addition, the Ministry of Civil Affairs provides disaster relief and income support. In order to co-ordinate the poverty programmes administered by the various ministries, agencies and local governments, the Leading Group for the Economic Development of Poor Areas was established by the State Council in 1986.

## Sustaining Reform

Although China's starting point as the centrally planned economy with the biggest population in the world was unique, in undertaking these economic reforms, China is finding itself confronted by a range of problems and imbalances familiar to other restructuring economies not just in the developing world but also among the OECD countries. Nonetheless, the reforms, when judged against the rapid economic growth they have unleashed, are strikingly successful; there is no convincing evidence yet that they have either overheated or run out of steam.

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