China’s Economic Reform and Development: A General Approach

A lecture to students from Flinders Univ., Australia

July 2014

Jihong Ding
School of Economics
Nankai University

Lecture Description

• This lecture will examine the performance of Chinese economy since 1978

  – Understanding China’s economy is of intrinsic interest as one-fifth of the world population live in China

  – It is also of interest in that China’s economic growth has effects far beyond China’s borders during the past thirty years.
• China is the world's second-largest economy

– Its GDP is 56.9 trillion yuan in 2013, with growth rate 7.7%

• Since the introduction of market-based economic reforms in 1978, China has become the world's fastest-growing major economy

• China’s GDP growth from 1979 to 2007 is 9.8% a year
China’s Growth Since 1949

- **China GDP:**
  - 67.9 billion yuan in 1952
  - 30 trillion yuan in 2008
  - **1952-2008 annual growth rate is 8.1%** (world average annual growth rate is 3.6% for 1961-2008)

---

**2009-2013 China GDP and its Growth Rate**

- 2009: 340903 billion yuan
- 2010: 401513 billion yuan
- 2011: 473104 billion yuan
- 2012: 519470 billion yuan
- 2013: 568845 billion yuan

- Growth rate:
  - 2009: 9.2%
  - 2010: 10.4%
  - 2011: 9.3%
  - 2012: 7.7%
  - 2013: 7.7%
China’s Growth Since 1949

- China GDP per capita:
  - 119 yuan in 1952
  - 22,698 yuan in 2008
  - 41,804.7 yuan in 2013

Readings

Main Topics

• Overview of the planning economy in the pre-reform period
• Overview of the post-1978 reform
• Economic growth & China’s miracle
• China’s Economic fluctuation

China’s Planning Economy
China’s Planning Economy

• The People’s Republic of China was established on Oct 1, 1949

• Since 1949, Chinese economy has made tremendous progress

The Planning Economy in the Pre-Reform Period

• From its founding in 1949 until late 1978, the P. R. China was a Soviet-style centrally planned economy

  – There was no private businesses

  • In Marxian economics, capitalism is a system based on exploitation
The Planning Economy in the Pre-Reform Period

• From its founding in 1949 until late 1978, the P. R. China was a Soviet-style centrally planned economy

  – Government’s central planning formulates all decisions about the use of resources, and controls all major sectors of the economy

Planning V.S. Marketing Economies

• **Scarcity** and **Choice** are the two essential ingredients of an economic topic

  – The resources are scarce while the desire is infinite

  – We must make a choice when we try to meet the desire with the scarce resources
In a market setting, production, distribution, pricing, and investment decisions are made by individuals based upon their interests rather than upon a macroeconomic plan.

- Price is used to ration goods and resources
- There are multiple markets
- Each market has its own supply and demand

Planning V.S. Marketing Economies

- **Price Floor** -> Excess
- **Price Ceiling** -> Shortage
Planning V.S. Marketing Economies

• In a planned economy, planners decide what should be produced and direct lower-level enterprises to produce those goods in accordance with national and social objectives. **Plan quota is used to ration goods and resources.**

Planning V.S. Marketing Economies

• The grain tickets, the cloth tickets, pork tickets, the oil tickets, …
Planning V.S. Marketing Economies

- Planning has the abilities
  - to channel savings into productive investment and
  - to coordinate economic activities that otherwise might not exist

- But the reality of central planning is that it is
  - technically difficult
  - highly politicized

The Planning Economy in the Pre-Reform Period

- Fast economic development in 1949-57
  - On the ruin of war, the national economy was recovered, and there was rapid growth of the industrial production
    - Between 1949 - 52, the average annual growth of total industrial output value was 34.8%
  - During the entire "First Five-Year Plan" period (1953-57), China's industrial production has made great achievements
    - The average annual growth rate of industrial value added was 19.8%, while 3.8% for agriculture
China’s Five-Year Plans

- China’s five-year plans are a series of social and economic development initiatives.
  - It started from the 1st plan in 1953-1957
  - The current plan is the 12th guideline in 2011-2015

- In order to more accurately reflect China’s transition from a Soviet-style planned economy to a socialist market economy with Chinese characteristics, the name of the 11th and 12th five-year programs were changed to “guideline” instead of “plan”.

The Planning Economy in the Pre-Reform Period

- The Great Leap Forward famine and the adjustment of national economy, 1958-65
  - The planned economy largely stagnated and was disrupted by the Great Leap Forward, which was an economic and social campaign, from 1958 to 1961, aiming to rapidly transform the country from an agrarian economy into a modern communist society through the process of rapid industrialization, and collectivization. The Great Leap Forward ended in famine, a disaster from grain shortage.

  - With three (1963-65) years’ comprehensive management of the national economic development, China’s economy was recovered. The industrial growth has significantly accelerated. The average annual growth of the industrial value added, was 21.4% during 1963-65.
The Planning Economy in the Pre-Reform Period

• Industrial economic ups and downs, 1966-78
  – The Cultural Revolution was a social-political movement from 1966 through 1976, which disrupted the economy, leading ups and downs of industrial economy
  – The national economy has not yet fully on track 1976-78

China’s Economic Reform
China’s Economic Reform

Since 1978, Deng Xiaoping and the new Chinese leadership began to reform the economy and move towards a more market-oriented economy with Chinese characteristics:

- “Free up our minds, Seek truth from facts”
- “No matter whether it is a white cat or a black cat, a cat that can catch rats is a good cat”
- We have to “wade across the stream by feeling the way”, since there is no previous experience to fall back on.

China’s Economic Reform

The strategic plan of modernization in three steps:

- Using 1980 as the base year, the first step is to double GDP in the decade from 1981 to 90, to solve the problem of food and clothing for people across the country.
  - The first step was actually realized in 1987

- The second step is to further double GDP in another decade from 1991 to 2000, so that people's living standards can reach a fairly comfortable level.
  - The second step was actually realized in 1995

- The third step is that until the mid-21st century, China's per capita GDP reaches the level of moderately developed countries in the world, people’s living standards are relatively affluent, and modernization is basically realized.
China’s Economic Reform 1978-84

• **Household-responsibility system**
  – By the late 1970s, food supplies and production had become very deficient
  – *First reforms began in agriculture*, a sector long neglected

In winter 1978, 18 farmers from **Xiaogang Village** pressed the red handprints in the land responsibility contract, in the way of “Tuogu”

• The "press" became the first declaration of China’s rural reform, and opened the prelude to China’s reform and opening up
China’s Economic Reform 1978-84

- **Household-responsibility system**
  - This system divided the land of the People’s communes into private plots
  - Farmers were able to keep the land's output after paying a share to the state (sell it in the market)
  - It increased agricultural production, and stimulated rural industry

---

Agriculture

- Since the reform, there has been a significant increase in grain and other major agricultural production
Agriculture

• Since the reform, the income of rural residents has been substantially increased, and their living standards are improved

  – In 1978–2007, the per capita net income of farmers increased from 134 yuan to 4140 yuan, after deducting price factors, the average annual increase of 7.1%

China’s Economic Reform 1978-84

• Reforms were also implemented in urban industry to increase productivity

  – A dual price system was introduced

    • State-owned industries were allowed to sell any production above the plan quota, and commodities were sold at both plan and market prices, allowing citizens to avoid the shortage of the pre-reform era

    – e.g.: oil price: 100 yuan per ton at plan price, while more than 600 yuan per ton at market price
China’s Economic Reform 1978-84

- China has experienced three shifts of dual price system to the one price system
  - the first is the production
  - the second is the RMB exchange rate
  - the third is in the capital market

RMB exchange rate, the review

China’s Economic Reform 1978-84

- Reforms were also implemented in urban industry to increase productivity
  - Private businesses were allowed to operate, and they gradually began to make up a greater percentage of industrial output
China’s Economic Reform 1978-84

• The country was opened to foreign investment
  – The government created a series of special economic zones for foreign investment that were relatively free of the bureaucratic regulations and interventions that hampered economic growth, i.e., Shenzhen, Zhuhai, Shantou, and Xiamen in 1980.

Shenzhen was a fishing village before 1980
Migrant workers moved to Shenzhen since 1980s
Today's Shenzhen
Famous billboard of Deng in Shenzhen
China’s Economic Reform 1978-84

• The country was opened to foreign investment

  – Special Economic Zones

  • Engines of growth for the national economy

  • Pilot region of reform. The main purposes and effects are:
    – to expand the country’s foreign trade;
    – to absorb more foreign funds, technology and management experience;
    – to increase employment opportunities;
    – to speed up the regional economic development, and the formation of a new industrial structure

China’s Economic Reform 1978-84

• The country was opened to foreign investment

  – Special Economic Zones

  • Hainan Province was established as SEZ in 1988

  • Kashgar in Xinjiang was established as SEZ in 2010

  • There are Development Zones in almost all cities/counties now
Four Steps of China’s Opening –up Process

• China’s opening up is from south to north, from east to west

• China’s opening –up process can be divided into 4 steps:
  – The first step is the founder of Special Economic Zones
  – The second step is to open the coastal port cities
    • 14 cities in 1984, e.g.: Tianjin, Shanghai
  – The third step is to establish a coastal economic open zones
    • Yangtze River Delta, Pearl River Delta and Minnan Triangle in 1985, Bohai Sea Open Area in 1988
  – The fourth step is to open cities along the Yangtze River, the inland cities and the border cities
    • 5 cities along the river in 1992, e.g.: Wuhan, Chongqing
    • 17 inland cities in 1992, e.g.: Changsha, Chengdu,
    • More than 15 border cities in 1992, e.g.: Heihe,

China’s Economic Reform
1985-93

• Township and village enterprises (TVEs)

  – TVEs, firms nominally owned by local governments but effectively private, began to gain market share at the expense of the state sector

  • State control began to be decentralized, leaving local provincial leaders to experiment with ways to increase economic growth and privatize the state sector

  • TVEs include enterprises sponsored by townships and villages, the alliance enterprises formed by peasants, other alliance enterprises, and individual enterprises located in townships and villages
China’s Economic Reform 1985-93

- **Township and village enterprises**
  - TVEs became the most vibrant part of the Chinese economy as they experienced significant expansion in the 1980s and early 1990s.
  - TVE employment grew from 28 million in 1978 to a peak of 135 million in 1996. In Jiangsu and Shandong, they employed some 30 percent of the rural workforce.

  ![Graph showing TVE employment growth](image1)

- Production of TVEs increased to 1.8 trillion yuan in 1992 from 49 billion yuan in 1978.

- In 2002, there were 21 million TVEs. GDP of TVEs was about 34% of China’s GDP.
China’s Economic Reform 1993-2005

• In 1997 and 1998, large-scale privatization occurred, in which all state enterprises, except a few large monopolies, were liquidated and their assets sold to private investors.

• Between 2001 and 2004, the number of state-owned enterprises decreased by 48 percent. The domestic private sector first exceeded 50% of GDP in 2005 and has further expanded since.

• However, some state monopolies still remained, such as in petroleum and banking.

China’s Economic Reform 1993-2005

• Dec 11, 2001, China formally joined the WTO
  – As of 2010, China’s all commitments of its access to WTO have been fulfilled
    • China reduced tariffs, trade barriers and regulations.
      – China reduced tariffs of imports from 15.3% in 2001 to 9.8% in 2010
    • China further expanded the service market opening. China opened 100, among 160 sub-sectors of the WTO Trade in Services Classification, close to the average level of developed countries.
      Covering finance, telecommunications, retails, household appliances, and etc.

澳洲联邦银行
(Commonwealth Bank of Australia)
China’s Economic Reform 1993-2005

- Dec 11, 2001, China formally joined the WTO
  - Joining the WTO has profound and long-term effects on China's economy, although short-term difficulties are inevitable
图4 中国外贸进出口及贸易差额变动 单位：亿美元

资料来源：据国家商务部数据制作。

China’s Economic Reform 1993-2005

-Foreign exchange reserves ranked first in the world
China’s Economic Reform 2005-Present

• **“Scientific Development”** was proposed by Former President Hu in 2003, and was implemented since the 11th Five-Year Guideline
  – Meaning: **People-oriented, comprehensive, coordinated and sustainable development**

![Diagram of Development Concepts](image)

China’s Economic Reform 2005-Present

• **“Scientific Development”**
  – Fundamental methods:
    • co-ordination of the **urban and rural development**, balancing **regional development**, co-ordination of **economic and social development**, co-ordination of human and nature harmonious **development**, co-ordination of **domestic development and opening-up**
Economic Growth & China’s Miracle

• Since the introduction of market-based economic reforms in 1978, China has become the world's fastest-growing major economy.

• China’s GDP growth from 1979 to 2007 is 9.8% a year.
Economic growth & China’s miracle

Growth rates of BRICS

Growth rate of real GDP per capita of BRICS and USA in 2001-2011

Source: World Bank
Economic growth & China’s miracle

- Demographic dividend & demographic liabilities
Economic growth & China’s miracle

- Capital accumulation during industrialization
  - Although China used to have more than 70% of population in rural areas, China’s economic growth depends not on agricultural sector but on the industrial sector, especially the expansion of the manufacturing sector.

  - China’s economic growth, to a large extent, is similar to the pattern of new industrialization strategy in East Asia’s emerging industrialized economies.
Economic growth & China’s miracle

- **Industrial scale** keeps growing. The dominant position of industry in the national economy has been strengthened. **China's industrial share of GDP is 46.8%**

![Graph showing industrial growth from 1978 to 2011.](image)

- **Economic growth & China’s miracle**

  - China's economic growth is in fact **driven by the manufacturing sector** rather than the agricultural sector

    - In theory, the growth of the industrialized type of format is **close to the neoclassical growth model**. The high savings rate and rapid capital formation is the main source of economic growth.
Economic growth & China’s miracle

- Industrialization is main engine of growth in China

This increase in industrial output is largely the result of the removal of barriers to entry and increased competition since the reform
Economic growth & China’s miracle

- **Industrialization** and **urbanization** are complementary with each other.
- China’s **urbanization rate** increased from 17.9% in 1978, to 44.9% in 2007, to above 52.57% in 2012.
  - Urbanization rate: proportion of urban population in the total population.

China’s urbanization

- Urban population
- Rural population

![Graph showing urbanization rate from 1978 to 2020.](image)
Economic growth & China’s miracle

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth rate</td>
<td>9.8</td>
<td>10.8</td>
<td>7.9</td>
<td>12.3</td>
<td>8.6</td>
<td>9.5</td>
</tr>
<tr>
<td>TFP growth rate</td>
<td>3.6</td>
<td>4.5</td>
<td>1.5</td>
<td>7.1</td>
<td>3.5</td>
<td>2.9</td>
</tr>
<tr>
<td>TFP contribution share</td>
<td>36.7</td>
<td>41.6</td>
<td>19.5</td>
<td>57.5</td>
<td>40.8</td>
<td>30.6</td>
</tr>
</tbody>
</table>

- It is expected that China’s TFP growth in 2012-2020 will still be around 2.5%-3%

Economic growth & China’s miracle

- Government’s education expenditure is 4% of GDP
Economic growth & China’s miracle

- China’s R&D expenditure was 1.83% of GDP in 2011

China’s Economic Fluctuation & Macroeconomics Policies
China’s Economic Fluctuation & Macro Policies

• **Before the reform**, there existed output **ups and downs**, sometimes negative growth.

![GDP Graph](chart)

China’s Economic Fluctuation & Macro Policies

• **Since the reform**, the output fluctuation has been decreased.

![GDP and CPI Graph](chart)
China’s Economic Fluctuation & Macro Policies

• Three components of demand are also called “three horses” driving Chinese economy ahead: consumption, investment, and export.

China’s GDP by Expenditure approach
Contribution Share and Contribution of the Three Components of GDP to the Growth of GDP

Data in value terms in this table are calculated at constant prices.

<table>
<thead>
<tr>
<th>Year</th>
<th>Final Consumption Expenditure</th>
<th>Gross Capital Formation</th>
<th>Net Exports of Goods and Services</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Contribution Share (%)</td>
<td>Contribution Share (%)</td>
<td>Contribution Share (%)</td>
</tr>
<tr>
<td></td>
<td>(percentage points)</td>
<td>(percentage points)</td>
<td>(percentage points)</td>
</tr>
<tr>
<td>1978</td>
<td>39.4</td>
<td>6.0</td>
<td>-5.4</td>
</tr>
<tr>
<td>1980</td>
<td>71.8</td>
<td>2.1</td>
<td>1.8</td>
</tr>
<tr>
<td>1985</td>
<td>85.5</td>
<td>10.3</td>
<td>-8.0</td>
</tr>
<tr>
<td>1990</td>
<td>47.8</td>
<td>3.7</td>
<td>-6.4</td>
</tr>
<tr>
<td>1995</td>
<td>44.7</td>
<td>6.0</td>
<td>0.3</td>
</tr>
<tr>
<td>2000</td>
<td>65.1</td>
<td>5.5</td>
<td>12.5</td>
</tr>
<tr>
<td>2001</td>
<td>50.2</td>
<td>4.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>2002</td>
<td>43.9</td>
<td>4.0</td>
<td>7.6</td>
</tr>
<tr>
<td>2003</td>
<td>35.8</td>
<td>4.0</td>
<td>7.6</td>
</tr>
<tr>
<td>2004</td>
<td>39.5</td>
<td>5.5</td>
<td>7.6</td>
</tr>
<tr>
<td>2005</td>
<td>37.9</td>
<td>4.3</td>
<td>23.1</td>
</tr>
<tr>
<td>2006</td>
<td>40.0</td>
<td>5.1</td>
<td>16.1</td>
</tr>
<tr>
<td>2007</td>
<td>39.2</td>
<td>5.6</td>
<td>18.1</td>
</tr>
<tr>
<td>2008</td>
<td>35.4</td>
<td>5.6</td>
<td>18.1</td>
</tr>
<tr>
<td>2009</td>
<td>47.6</td>
<td>5.6</td>
<td>-6.0</td>
</tr>
<tr>
<td>2010</td>
<td>36.8</td>
<td>4.3</td>
<td>9.2</td>
</tr>
</tbody>
</table>

- Contribution share of the three components to the increase of the GDP refers to the proportion of the increment of each component of GDP by expenditure approach to the increment of GDP.
- Contribution of the three components to GDP growth refers to the growth rate of GDP multiplied by the contribution share of the three components.

China’s Economic Fluctuation & Macro Policies

- The fiscal revenue in 2011 was 10.3740 trillion yuan, about 22% of GDP.
China’s Economic Fluctuation & Macro Policies

- China’s **government debt is safe**, controlled
  - In the end of **2011**, Chinese government has total liabilities of 19.9 trillion yuan, **42%** of GDP, which is **below international warning line** 60%
  - The public debt ratios in such **developed countries** as France, Germany, Japan, the United States, and United Kingdom are all about **twice** that of China
  - The average ratio of **OECD** is **more than twice** that of China
  - the ratios of BRIC other three countries are also **significantly higher** than that of China

- China’s **money growth rate was higher than its GDP growth rate** in decades, leading to rises of CPI
  - The annual growth rate of **nominal GDP** was **16%** in 1978-2009
  - The annual growth rate of **M2** was **22.5%** in 1978-2009

China’s money growth rate, GDP growth rate, and CPI growth rate since 1980
China’s Economic Fluctuation & Macro Policies

- China’s **currency rate**, measured by the M2/GDP, is high (178% in 2009)