

CHINA ECONOMY - REFORMS OF 1978



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INTRODUCTION

China's economic reform toward a market-oriented economy began in 1978 and has been recognized as essentially successful. The average rate of growth of real GDP in the first two decades of reform was about 9.6 percent annually according to official statistics. I emphasize more on the topic " Why was economic reform introduced in 1978? " and my learning is also explained in the report.

WHY WAS ECONOMIC REFORM INTRODUCED IN 1978?

Beginning in the early 1950s economic planning was introduced in China that was modeled after the planning system of the Soviet Union. The first Five-Year Plan was initiated in 1953-7. It was in 1978 that China started to abandon the planning system gradually and return to a more market-oriented economy. When I asked a former top Chinese government official why reform was initiated, his reply was that the Communist Party simply resumed the course for developing the Chinese economy as set forth in the four modernization (of agriculture, industry, science and technology, and defense) announced by Premier Zhou Enlai in December 1964. According to this official, the plan for modernization was interrupted by the Cultural Revolution of 1966-1976 and should be resumed as soon as the Cultural Revolution subsided. Of course, even if the Communist Party had had some plan for developing the Chinese economy it might take a different course later under a different set of circumstances. It had adopted a planning system in the 1950s but decided to abandon it.

I would like to propose the following as possible reasons for economic reform to be introduced in 1978 :

End of Cultural Revolution of 1966-1976 :

First, the Cultural Revolution of 1966-1976 was very unpopular. The Chinese Communist Party and the government had to change direction in order to get support from the Chinese people. Party Chairman Mao Zedong who engineered the Cultural Revolution died in 1976. The Gang of Four who seized power and supported that ruthless political movement was soon eliminated. Deng Xiaoping became the leader of China because the top Party leadership supported him. It was time for him to make the move to change.

Weakness of Planning System:

Second, many economic planners had learned from experience that a planning system was difficult to manage and economically inefficient. This is witnessed by the writing of economic officials that appeared in the late 1970's, although the understanding of the weakness of the planning system varied among these officials.

Examples from Neighbouring Economies:

Third, rapid economic growth and development that took place in the more market-oriented neighboring economies served as examples that a market economy can perform better. The neighboring economies included Hong Kong, Taiwan, South Korea, and Singapore. The contrasts in the economic performance between North and South Korea, between East and West Germany, and between Eastern and Western Europe reinforced this point.

Support from the people :

Fourth, for the reasons stated above the Chinese people desired a market-oriented reform and would support it. The Chinese people had also suffered through the economic consequences of central planning, including the shortage of consumer goods, the limited variety, and the lack of improvement in quality. They had to kowtow to the suppliers of consumer goods and waited in long lines to get what was needed. They had to go through the "back door" (or use personal connections) to get what was considered essential consumer goods.

Given these four reasons, economic reform seemed inevitable. There are also supporting human factors favoring the initiation of economic reform. First is the person of Deng Xiaoping. Before Mao died he had designated Hua Guofeng to succeed him as Chairman of the Communist Party. Deng had to take over the leadership from him before trying to reform the economic system. Deng's leadership during the reform process was recognized to be important. However, given the above four reasons another leader who was able to gain support from the

Party leadership and the Chinese people would have had to initiate changes, even if not as effective as Deng.

My learning :

The topic of this report is economic reform and growth in China. Basically, Economic reform consisted of changes in economic institutions toward those of a market economy, with the changes taking place step by step depending on the results of and experience gained in previous steps. Many shortcomings of the Chinese market institutions remain, but rapid economic growth continues in spite of the deficiencies in the market institutions. There is no question that reform has contributed to growth, as evidenced by comparing the rates of increase in total factor productivity before and after 1978, the former being zero and the latter close to three percent per year. While replacing the previous system of economic planning by market institutions is necessary for growth, it is not sufficient. The second most important factor is the quality and quantity of human capital in China and of the Chinese overseas. By human capital, in China I include the cultural tradition of hard work and entrepreneurship and the high regard for education. Such human capital can be demonstrated by the economic performance of the Chinese in several Southeastern Asian countries. We may draw one important conclusion from China's reform experience that market institutions alone are insufficient for economic development, and human capital is the second most important factor. Market institutions and high quality human capital are necessary and sufficient for rapid economic development.

As the second conclusion, economic growth can take place under different political systems. If market institutions and human capital are sufficient for economic growth, then growth can take place under different forms of government. In particular, rapid economic growth can take place with or without democracy, as it is demonstrated in Hong Kong and Singapore. Rapid economic growth can occur under a one-party political system as in Taiwan from the 1960s to the 1980s and in Mainland China in the last two decades of the 20th century. The nature of the political system such as Communism is also irrelevant.

Third, China's reform experience shows that enterprises of other form than private enterprises can be economically efficient. There have been efficient state-owned and collectively owned enterprises in China. One important factor accounting for economic efficiency is the existence of competition from other enterprises. Private ownership is not as important as the following two

conditions that are sufficient for enterprise management to work hard for the enterprises. The two conditions are first, the manager should not be able to benefit economically without working hard for the enterprise and second, by working hard he or she will be financially rewarded. The first condition can come about if there is competition and if the manager can be held financially accountable. The second condition will result if the manager is allowed to share a part of the profit of the enterprise. These two conditions can serve as the basis for the design of corporate governance.

Fourth, alternative economic institutions can serve a market economy. An interesting phenomenon was the blossoming of township and village enterprises operating without clear property rights and the protection of a well-functioning modern legal system. A market economy can flourish under different legal systems and different forms of ownership structure. The study of a variety of legal systems and of ownership arrangements provides challenges to economists accustomed to observing the functioning of private enterprises under a Western legal system.

Fifth, political feasibility is an important consideration in the adoption of economic reform measures. Political feasibility affects both the general direction of economic reform and the particular steps to be taken in particular areas and in particular times. It was not possible to introduce reform towards a market-oriented economy while Mao was alive or when the Gang of Four, supporters of the Cultural Revolution, was still in power. Entitlement of certain privileges made rapid decontrol of prices and urban rents politically not feasible in the early 1980s.

Sixth, bureaucratic economic institutions under central planning are difficult to abolish. Agriculture was privatized overnight, but state enterprises and state banks could not be changed rapidly. The success of reform in agriculture seems to favor "shock therapy" as a strategy for reform, but the failure in reforming state enterprises and banks seems to raise doubt on the possibility of a quick transformation. In general it is difficult to change any institution that is controlled by politically powerful bureaucrats who are accustomed to old ways of doing things and to the entitlement of certain economic benefits. The farmers in a household farm were not such bureaucrats. The Commune leaders supporting the household responsibility system did not lose anything by allowing the farmers to farm separately as long as they could collect the same amount of output from the farmers. The managers of state enterprises and state banks would lose their privileges and would not know how to manage after privatization. Some of these bureaucrats could not be easily dismissed because they had political support from certain

top government officials. The successful state enterprises were those managed by bureaucrats who were not given vested interest, could be dismissed if profits were low and were allowed to share a part of the profits. These enterprises were usually subject to competition from other enterprises in the market place. As long as the Chinese Communist Party remains in power, the bureaucrats who are party members will try to maintain and exploit their economic power if possible