

Chinese Political Reform and Economic Transition

Course: ECO435

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1. Introduction

After decades of reform and exploration, China has gradually realized the transformation from an extremely centralized economic system under government control to a socialist market economic system. More importantly, Chinese economic strength and comprehensive national strength have entered the forefront of the world. Institutions' political reform profoundly influenced China's economic progress and motivated the modern economy's transition during this period.

Government reform is an essential factor that has profoundly influenced and shaped China's economic transition. For China, the economic reform aims to shift the national economy from a command, planned economy to a mixed, market-based economy. Therefore, to create vigorous markets in the economy, the government needs to help transform those highly interventionist governments into ones that promote decentralized economic activity (Jin et al., 1723). The milestone in Chinese economic history is the economic reform launched by Deng Xiaoping in 1978. Deng Xiaoping proposed the new "open door" policy to introduce foreign technology and attract new investment, initiating the process of Chinese economic transition. Since the late 70s of the 20th century, local government officials have made great efforts to consolidate basic infrastructure construction; they have endeavored to encourage local enterprises to be more active in the national and global markets. The decisive role of local officials in China contrasts sharply with the rent-seeking behavior of local officials in other transition and developing countries (Li & Zhou, 1748).

Hence, reviewing the course of political institutions and economic structural reform and analyzing the different roles of government played in the Chinese economy will help explore

the interactions between politics and economic reforms. More specifically, it will offer a new angle to see how the structure of political institutions in China shapes the evolution of economic reform and give us potential implications for national economic outcomes.

2. The uniqueness of China's political system structure

The ruling system is centralized and vertical, layer by layer, in the Chinese political system. This system has four levels of local government: provincial, municipal, county and township. The central government has only direct control on the part of the national economy. Thus, sub-national governments have the authority and delegation to carry out most of the economic plans and policies. The regional administration is responsible for a broader range of regional affairs than simple financial issues (Xu 1089).

In a command economy controlled by centralized political power, people would be lazy because profit does not directly link to their performance in the workplace. For example, farmers' hard-working harvest needs to be shared equally with others in their rural cooperatives. Essentially, the original economic system of China is a kind of dysfunctional economic system in which economic activities are only regulated and assessed based on government planning. The government played a dominant role in the market, putting forward the overall objectives of national economic development and forcing the market entities to achieve the goals by no means. The allocation of resources is only directed and determined by government planning. However, a mixed economy based on a liberal market is different, which refers to the economic operation of allocating social resources through the market mechanism. More importantly, the market has its orders and governs itself (Lai 46). In such a liberal market, investments need to

be rewarded, and it could encourage autonomy, equality, competition, and openness. However, in China at that time, government agencies provided grants to enterprises, and the party secretary directed corporate direction, causing competition to disappear. Furthermore, since the state-owned enterprises could not lay off employees, managers would not push their subordinates, and subordinates would not have performance pressure, which made many enterprises support many idlers who did not participate in work. These factors slowed China's corporate inefficiencies and domestic economic growth.

3. China's political system before 1978

A typical figure who dominates the central decision-making of the Communist Party of China is Mao Zedong (Xu 1093). Soon after the Chinese Communist Party took power, a centralized political power system gradually occurred. Although the region-based organizational structure was retained, in the early 50s of the 20th century, some influential regional leaders were advanced to superior leadership and were assigned to the national capital, Beijing. By significantly weakening regional leadership, the centralized power mechanism greatly consolidated Mao's dominance in the Chinese Communist Party, enabling him to become a dictator who could nearly determine every aspect of society (Xu 1095).

In 1958, the Communist government under Mao Zedong launched the "Great Leap Forward" movement with great fanfare. The Great Leap Forward was an abnormal development movement that aimed to accelerate industrialization by "squeezing" the agro-cultural sector. The first goal of the Great Leap Forward was to rapidly increase agricultural and industrial output several times (Kung and Chen 35). During the GLF (Great Leap Forward)

movement, most parts of the government-owned enterprises were under the control of sub-national governments. The central government's planning has been replaced by the fierce competition between regions, where regional governments were advocated to fight with each other to exceed programmed goals (Kung and Chen 41).

A famous slogan in the commune canteen was "Open your stomach, eat as much as you wish, and work hard for socialism." (Zhang and Wen 8). The commune catering seriously undermined the enthusiasm of commune members. Quite a few pretended to be sick or did not work. Many people came to the restaurant during meals, but even fewer went to work in the fields. Uncontrolled food waste, false agricultural figures, and agricultural farming programs without an incentive system made famine widespread in the spring of 1959. The famine later worsened in late 1959 in at least ten provinces in China (Zhang and Wen 21). Over time, the Great Leap Forward's economic frenzy and the commune system's irrationality began adversely affecting food production.

The administrative centralized planned economic system led to a slash in economic improvement, a severe lack of construction funds, and a limited presence in the global market. During this period, the Chinese government implemented a command economy, in which planning, and intervention achieved tight control over the national economy's operation, making all production and distribution decisions. Prices are the primary variable in market regulation, yet in the economic structure of a command economy, the central government holds most of the means of production, including land and capital. Thus, there was no exchange value, no actual price, and the private and individual economies were significantly suppressed, labor and capital flooding into state-run enterprises. Worse still, the primary form of the planned

economic system also rendered an illusion in people's ideological concepts, believing that engaging in a planned economy means practicing socialism.

4. Chinese political reform in 1978

After Mao died in 1976, the rural revolution rendered the Maoist economic approach incredible because living standards had not improved for two decades. Deng Xiaoping, restated at the end of 1977, began to launch a series of political and economic reforms. He believed that the challenge was making the command economy work better rather than abandoning it altogether. The need for institutional reform was undeniable at that time ("Reform and Opening" 545). The Third Plenum was a watershed in China's political, economic and social development. On 13 December 1978, a new tone of economic development was set to encourage new thinking and focus on practice and concrete improvements in living standards. More importantly, it marks a radical departure from the Mao era's insistence on theoretical purity as a turning point that inspired optimism and enthusiasm in China and abroad.

Deng Xiaoping's political reform aimed to render a favorable institutional condition that encouraged individual initiative, liberalization, creation, and challenges. Perhaps most important is the Chinese government's opening up to Western markets, mainly introducing foreign investment and advanced technology in the domestic to improve productivity. To diminish the central government's role in the market, the government released a series of policies to reduce the tax burden of private economies and give financial assistance to encourage entrepreneurship. China's economy had successfully embarked on the path of rapid development.

During the period of reform and opening, the power of the CPC was entirely decentralized, and the central and regional governments worked together to make strategic decisions on economic issues. Thus, after 1978, China began transitioning from a command economy to a market economy. Notably, in 1980, China decentralized its fiscal and credit system, allowing central and local governments to share revenue based on joint contracts. The local officials were incentivized to help local enterprises motivate regional economic growth. Besides, the personnel management system was also improved, which not only offered incentives for locals to improve the productivity but also integrated China's adjusted fiscal system into the local governments. More power was distributed to subordinate governing bodies rather than concentrated in the hands of one leader (Li & Zhou, 1756). The reform has dramatically emphasized the function of the financial incentives of the provincial governments and brought significant benefits to the development of the provincial economy. That is, there is a distinct correlation between the regional government's fiscal incentives and the regional economic performance. Provincial governments entitled to attracting financial incentives usually make more efforts to generate a healthier local business environment that inoculates new economic growth points, while provinces with lower financial incentives are the opposite (Jin et al., 1733).

5. Economic changes triggered by policy reforms

Changes in the decentralization policy have led to the continuous entry and expansion of private enterprises. From 1978 to 1991, the share of private enterprises in national non-farm employment significantly increased (Qian and Xu 158). Along with high growth rates, private enterprises have a higher productivity rate than government-controlled enterprises. The annual

production growth rate in non-government-owned enterprises is much higher than that of government-owned enterprises (164).

One of the most significant changes in the national economy after 1978's political reforms is the implementation of ownership reform for various market entities. Notably, the government-controlled economy has gradually withdrawn from some competitive industries such as trade, finance, and catering. The private market entities such as private enterprises and individual entrepreneurs seized the precious opportunity to expand their market share and become increasingly active in economic affairs. Implementing some reform policies demonstrates that power has been decentralized to sub-governments. The central government not only focused on consolidating public-owned enterprises but also took adequate steps to encourage and support the development of non-public components in the economic system. In 1981, the State Council issued the "Certain Policy Provisions on Non-Agricultural Individual Economy in Cities and Towns", and the state officially recognized the legal status of individual households, and the private economy regained its right to exist.

On the price reform side, China has successfully transitioned from a planned economy to a market-oriented economy, from strict price control by the central government to a two-track system of prices and then to price convergence, which alignment with international markets. Initially, all resources were in the hands of the central government, and only state-owned enterprises (SOEs) and production materials were priced uniformly by the central government. At the beginning of 1985, China announced the removal of restrictions on the prices of products sold by enterprises outside their plans, protecting the price advantage of state-owned enterprises over private enterprises in the purchase of raw materials, announcing the formal

formation of a 'two-track price system'. The "double-track system," which had clear signs of a planned economy, helped to contain price increases and inflation but also posed a significant obstacle to the expansion of private enterprises for a long time. However, the two-tier price system of prices has led to corruption and the sale of large amounts of state assets at low prices. As reforms continued and a market economy was established, the dual-track price system gradually shrank. On 1 September 1992, the State Price Bureau announced that the pricing power for 571 products would be given to enterprises, and the prices of 22 products would be devolved to provincial price departments, which represented the end of the dual-track price system.

In terms of the financial system, a modern economic system has gradually emerged and developed under the guidance of China's central bank. Commercial finance has become an indispensable part of the financial system, and numerous private financial institutions have appeared. An orderly and liberal financial system has been established since 1978, and government-owned banks and private financial institutions have worked together to promote the efficiency of the financial market environment in China.

Also, China has embarked on a new journey of reform and opening up, and this opening up has been carried out effectively. Since 1978, China has gradually become friendly with other countries in the world, which is conducive to trade and exchanges between China and other countries' economies. Active participation in world production has promoted China's economic development and injected a boost into the world economy. By 2001, China joined the WTO, the scope of opening continued to expand, and the economy continued to develop rapidly. In 2008, China proposed the "four trillion plan" to alleviate excess production. After that, China

proposed the "One Belt One Road" plan to strengthen its economic relations with other countries worldwide.

6. Conclusion

Based on the Chinese economic transition and the different roles of government has played in the market, we can conclude that, on the one hand, the highly centralized political power has dramatically influenced the national economy, undermining the creativity and initiatives of market individuals. Liberalism, on the other hand, would motivate the improvement of the economy and bring more vitality into the free market. In China, the liberal market is intertwined with the government's macroeconomic regulation and control to ensure a healthy and orderly market environment while maximally stimulating the initiatives of private companies.

From Chinese political reforms and economic transition since 1978, we can tell that the organizational structure of the national economy is indeed highly associated with political policies, which may give some political implications for other developing countries to accomplish the transformation of the modern economy smoothly. First, the decentralization of political power is desirable and conducive to the growth and development of non-government-owned enterprises. The policy of opening and decentralizing government-owned enterprises has encouraged competition and facilitated the new entry and national economy. Second, the central government and dynamic regional governance should work together to inspire the vitality of a liberal market. This requires reducing and limiting central discretion while strengthening local governments' power in regional economic reforms. With less discretion of the central government, regional transformation and development will be more stable and

progressive, less affected by fluctuations caused by the economic policies of a centralized political power (Qian and Xu 167). This will reduce the uncertainty generated by politically opportunistic behavior or power struggles between different factions in the central government.

However, China's progress cannot simply be replicated in other transitional economies because the structure of the Chinese economy is unique compared to other countries. Countries in transition should proceed from their reality and make appropriate policies to improve productivity further, spur the vitality of market entities, and create more favorable conditions for future development. Politics and economics are deeply entangled, and the government should take action to display a positive role in economic and political progress. Besides, government and business, central and regional authorities should work together to drive economic transformation when considering the trend of international economic development. In the era of global economic integration, economic transformation and political reforms must keep up with the current pace of scientific and technological development and grasp the trend of world economic development.

To conclude, although China made significant progress in its economy along with its political reforms in 1978, difficulties have engulfed China's economy on all sides. For example, economic growth has stagnated, the unemployment rate is at record highs, the property market is tumbling, and companies are grappling with supply chain problems. China's economy is clearly in serious problems. One of the main reasons is the extreme anti-epidemic policy, with massive testing and lockdown as the essential measures implemented by the Chinese Communist Party. To address the current economic difficulties, the government needs to take

more responsibility to help the national economy recover from the epidemic. Market entities should strengthen their confidence in the economy to engage more in various economic activities, pouring new vigor into the liberal market.

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