

# An Unusual Path of Transition from Plan to Market

- Uninterrupted growth since 1979
- Unprecedented since at least 1840
- *Ex ante* it was not clear if China could muddle through
  - Doubts in the late 1970s and early 1980s
  - More doubts in 1989 and early 1990s
  - Still more doubts after the Asian crisis in 1998

# An Unusual Path of Transition from Plan to Market

- Economists have not anticipated this
  - Ask an economist in 1988 which country would come first economically, China or the Soviet Union?
- Political scientists have predicted otherwise
  - China was, and still is, a Communist country
  - Political liberalization should come before economic liberalization

# Quotation from Shirk

“We usually think of communist political institutions as rigid and hostile to innovation. We expect communist party and government officials to defend their vested interests in the command economy by blocking market reforms. Gorbachev's effort to change the political rules of the game before transforming the economic system accords with our views of communism better than Deng's strategy of economic reform without political reform does.” (Susan Shirk, *The Political Logic of Economic Reform in China*, 1993)

# Big Debate on Reform Strategy

- China vs. Eastern Europe
- Alternative reform strategies
  - Gradualism vs. big bang
  - Economic reform first vs. political reform first
- Ideas for social transformation
  - What types of social engineering
  - Can social transformation be designed

# Evolution in Four Stages

- 1979-1992: the first stage, growing out of the plan.
- 1993-2001: the second stage, building the market system
- 2002-2012: the third stage, integrating to the global economy
- 2012-?: back to ... ?
- They evolved, were not planned

# 1979-93: The First Stage

- Phase I (1979-83): The start of reform
  - December of 1978: the 3rd Plenum of the 11th Chinese Communist Party Congress
  - Economic development as the Party's “key task”
  - Two key phrases: “reform” and “opening up”
  - The framework: “planning as the principal part and market as a supplementary part”
  - Reforms: Agriculture, foreign investment, special economic zones, profit incentives, fiscal decentralization, etc.

# Decollectivization

- In many places, communes had been disbanded spontaneously.
- Experience in Sichuan province of “Household responsibility system” later generalized to whole country.
- Households receive 15 year lease, delivery quotas to state and freedom for residual production.
- Labor force freed worked in township-village enterprises.

# Fiscal decentralization

- Similar to the household responsibility system, provinces signed contracts with central government to hand over fixed sum or tax revenues (or share) to central government.
- These contracts gave provincial leaders an incentive to increase the tax base and to maximize growth (promotion incentive).



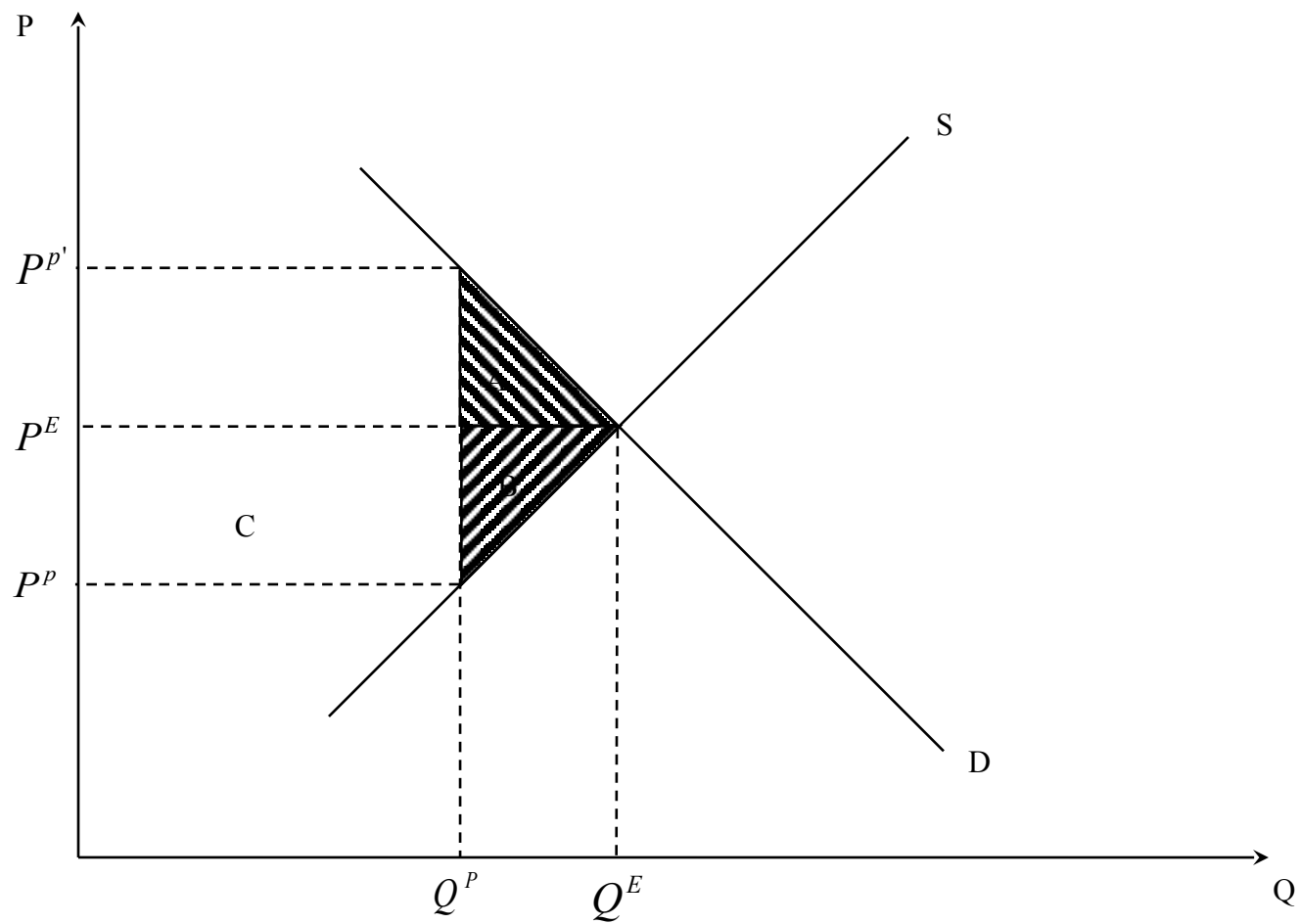
# 1979-93: The First Stage

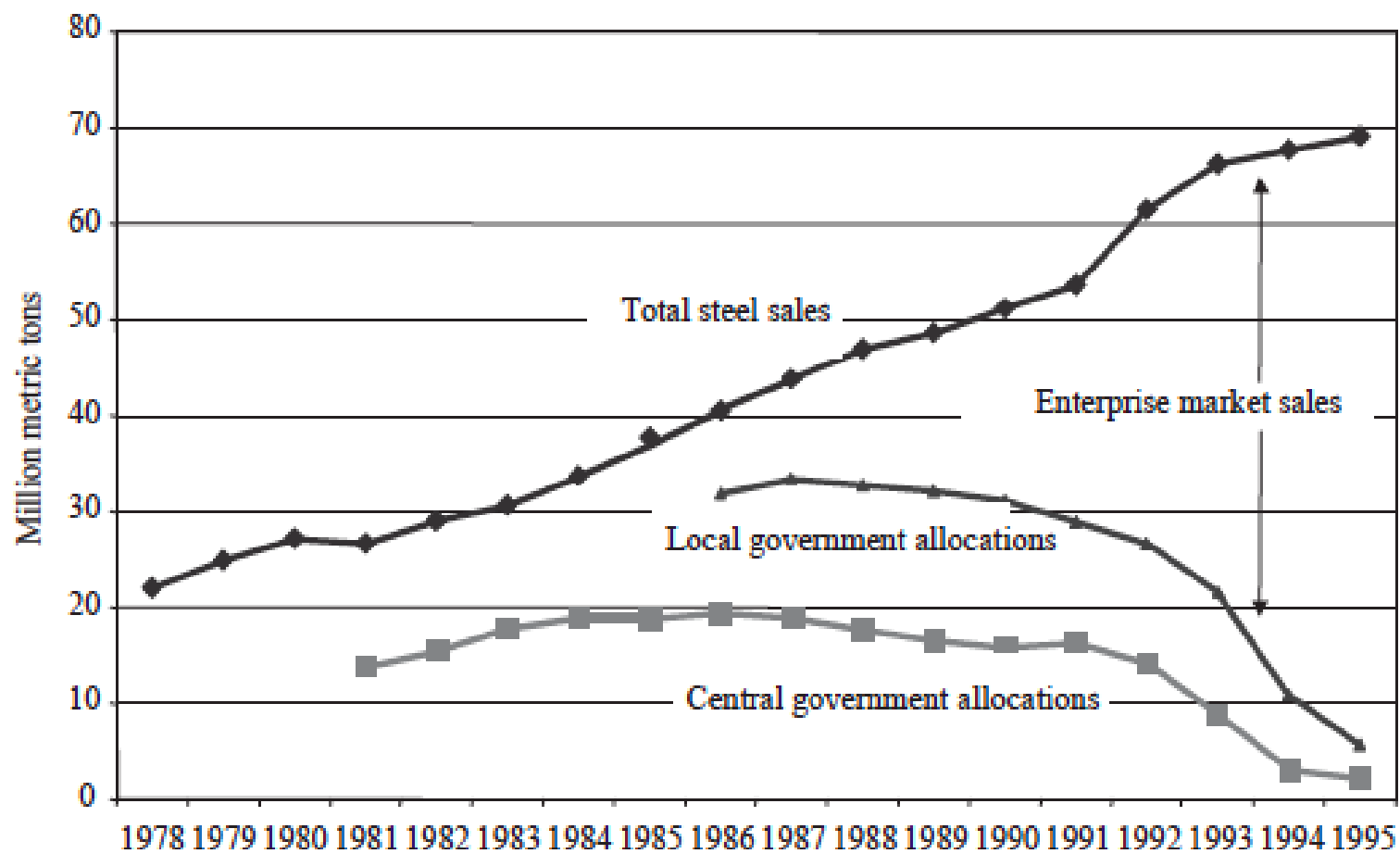
- Phase II (1984-88): High wave of reform
  - Agricultural success: grain production increased from 319 kg to 400 kg (per capita) between 1978 and 1984, rural income (per capita) increased by more than 50%
  - Boost of reformers' confidence and popular support
  - October 1984: major decisions on urban reform
  - The framework: “planned commodity economy”
  - Reforms: Market price liberalization, managerial incentives in state-owned enterprises (SOEs), coastal open cities and development zones, financial reform

# Dual-track liberalization

- Similar to the household responsibility system.
- Plan track: obligation to fulfill plan contract (planned quantities and prices).
- Market track: freedom at the margin to sell residual quantity at free market prices.
- Price liberalization at the margin.
- Concern to avoid production disruption.

## The dual-track: a simplified representation.





**Figure 4.1**  
Steel production and planned allocation

# Special Economic zones

- First 5 special economic zones: Shenzhen, Zhuhai and Shantou in Guangdong province, Xiamen in Fujian province and Hainan.
- Later extended.
- Initially, goal was to produce for export without disturbing the domestic economy.

# 1979-93: The First Stage

- Phase III (1989-93): Retreat and revival of reform
  - Problems of inflation and corruption
  - June 4, 1989: Tiananmen Square
  - Central government retreat of reform
  - Some local governments continued reform, especially in coastal provinces
  - January and February of 1992: Deng Xiaoping's "Southern tour"

# 1994-2001: The Second Stage

- September 1992: “socialist market economy”
- November 1993: a blueprint for building a market system
- January 1, 1994: a series of major reforms
  - Foreign exchange reform
  - Tax and fiscal system reform
  - Monetary and financial reform
  - Social safety net
  - Privatization of small SOEs

# 1994-2001: The Second Stage

- March 1999 Constitutional amendments
  - On private ownership
    - Old: the private economy is a **supplement** to public ownership
    - New: private ownership is an **important component** of the economy
  - On rule of law
    - “Governing the country according to law”



**Table 4.1**  
**Contrasting styles of economic reform**

1980s reform	1990s reform
Zhao Ziyang: cautious, consensual decision-making	Zhu Rongji: Rapid, personalized decision-making
Introduce markets where feasible; focus on agriculture and industry	Strengthen institutions of market economy; focus on finance and regulation
Dual-track strategy	Market unification, unite dual tracks
Particularistic contracts with powerful incentives	Uniform rules: "level playing field"
Competition created by entry; no privatization	State-sector downsizing; beginnings of privatization
Decentralize authority and resources	Recentralize resources, macroeconomic control
Inflationary economy with shortages	Price stability, goods in surplus
"Reform without losers"	Reform with losers

# 2002-2012: The Third Stage

- December 11, 2001: China entered the WTO
- 2002-2006: a five-year window period for transition
- Accelerated growth between 2003 and 2006
- A lot of infrastructure investment: roads, highways, railroads.
- Emphasis on inland provinces, growing more slowly than coastal provinces.

# 2002-2012: The Third Stage

- November 2002: 16<sup>th</sup> Congress of the Chinese Community Party
  - Capitalists/entrepreneurs can join the Party
  - Leadership change peacefully
- March 2004: Constitutional amendment on private property rights
  - “The lawful private property of citizens is not to be violated.”

# 2002-2012: The Third Stage

- New problems
  - Inequality
  - Corruption
  - Social unrest
- New catch phrases
  - “Harmonious society”
  - “Peaceful development”

# 2002-2012: The Third Stage

- The new technology
  - The Internet and the web
  - Cell phone (short message service, SMS)
  - The satellite and cable TV
- The media
  - Continued Party crackdown on the media
  - Social media exposure may lead to policy shifts
  - Media's role in the rise of populism

## 2012-present: Fourth stage

- November 2013: third plenum. Market should play a “decisive role” in the economy.
- Reform of “one child policy”.
- In practice, emphasis on anti-corruption, reinforcement of party and state.
- Changed spirit after 2008 crisis. Will to go for “Chinese model” with large state sector, tighter party control over enterprises, rein in expenses of bureaucracy.

## 2012-present: Fourth stage

- Crackdown on Ant Group and Didi.
- Regulation of fintech but also data protection.
- “Common Prosperity”. The rich are asked to help.
- Cultural crackdown on movie stars and pop music stars, gaming, “effeminate” boys.