

# Economic Policy Reversal

## Econ 43750

*N.C. Mark*

University of Notre Dame and NBER

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## Turning Point: Tianamen Square Protest and Massacre

- BBC short documentary on Tianamen Square protest and crackdown.  
<https://www.youtube.com/watch?v=S3RzKKfNkTk>
- CBS news. Tiananmen survivor reflects 30 years later. (copy and paste url)  
[https://www.youtube.com/watch?v=PE\\_1VGdDI5Q](https://www.youtube.com/watch?v=PE_1VGdDI5Q)
- A short by the Guardian  
<https://www.youtube.com/watch?v=4woMuFZA88>
- Tank man  
<https://www.youtube.com/watch?v=9-nXT81SnPQ>.
- Five Facts about Tianamen Square Crackdown  
[https://www.youtube.com/watch?v=am\\_dGC4coM4](https://www.youtube.com/watch?v=am_dGC4coM4).
- A very good but very long (too long IMO) documentary on the Tianamen Square protests and government response: The Gate of Heavenly Peace: Tianamen Square Protests  
Part 1: <https://www.youtube.com/watch?v=1Gtt2JxmQtg&t=7s>  
Part 2: <https://www.youtube.com/watch?v=o0lgc4fWkWI>

## What Led to The Protests

- Tiananmen Square protests and subsequent crackdown is taboo subject in China
- People were obviously fed up.
- Student Demands
  - Reevaluate government treatment of Hu Yaobang and endorse his views on democracy ([freedom](#))
  - End campaigns against spiritual pollution and bourgeois liberalization. ([freedom](#))
  - Publish salaries and assets of government leaders and their families ([corruption](#))
  - End Government censorship of the press, allow publication of private newspapers ([speech](#))
  - Increase government spending on higher education, increase wages for intellectuals ([crummy living conditions](#))
  - End restrictions on demonstrations in Beijing ([speech](#))
  - Hold democratic elections to replace corrupt or ineffective officials appointed by the CCP ([corruption](#))
- Government stalled and wouldn't meet with them (sound familiar?)
- Hunger strikes
- These were concerns of **urban** youth. The rural areas were doing well up to now.

## What Led to the Protests

- Top echelons of the party: Reformers had rural backgrounds, were from the rural areas. Conservatives had urban backgrounds.

- From Orlik:

*In 1988, the mood was different. Seizing the opportunity presented by spiraling inflation, Chen and the conservative planners redoubled their retrenchment policies. Investments were cut back, price controls reimposed, credit quotas strictly enforced. The result was a classic example of “operation successful, patient dead.” Inflation was lowered, but only at the expense of hammering growth and jobs. In 1988, GDP expanded 11.3 percent. In 1989, it plummeted to 4.2 percent. The one-two punch, first high inflation hammering purchasing power, then slumping growth hitting wages and employment proved disastrous. Public servants, already incensed at the corruption of senior officials and their families, saw soaring prices eroding the buying power of already meager salaries. Migrant workers, pulled into the big cities by the 1980s construction boom, found themselves jobless as investment projects were curtailed. It was in this atmosphere that the Tiananmen protestors’ call for greater political freedom found an echo in wider social discontent, triggering first mass protests, then a draconian response from Deng and the Party elders.*

## Policy Reversal (Huang)

- In the 1990s TVEs began to fail.
- 1989, the year of Tiananmen, Nian of Idiot's seeds was arrested, charged with corruption and embezzlement of state property. City government shut down his firm.
- Post-Tiananmen conservatives cracked down on the private sector. Since 1993, bias towards
  - Urban areas
  - Foreign capitalists (FDI) over local capitalists
  - technocratic development and industrial policy in favor of large firms.

Balance of power tilted away from rural China.

- After Tiananmen, (1989-1992) leadership changed towards conservative leaders from urban areas. Before Tianamen, they were from rural areas.

## Transition (the Interlude, 1989-1992, (Naughton))

- 1980s was known as **Reform Without Losers**. Some people gained, but nobody lost out.
- After Tiananmen Square, conservatives gained power. But they underestimated how much people hate inflation and popularity of reform. Conservatives tried to roll back reforms. Reforms popular because benefits were widely shared.
- Then the conservatives lost influence, economic reform **resumed** in 1992-1993. Kick started by Deng's **Southern Tour**.
- Message: continue reforms, experiment with different things, downplay ideology. All that matters is growth, and preserving power of CCP.
- Marked the end of reforms/progress in rural areas. End of rural dynamism. Policy biased against rural areas.

# Special Economic Zones. Visited by Deng on Southern Tour

- 1980s: China needed to import technology (due to its backwardness)
- Not so simple as reading stolen blueprints. (e.g., cooking from a recipe, versus being taught)
- Original plan was to trade oil for technology. That didn't work. Change strategy, with SEZ
- Initially established 4 of them
  - Shenzhen (near Hong Kong)  
<https://cdn.architecturendesign.net/wp-content/uploads/2016/08/AD-How-Famous-City-Changed-Timelapse-Evolution-Before-After-10.jpg>  
<https://www.youtube.com/watch?v=y0pq1qM5rJU>
  - Fujian province (near Taiwan)
  - Hainan province. (get that Fortune article)
  - Pudong area (Shanghai)
- Inside the zone import and export tariffs were relaxed, and businesses could operate according to market principles, free of the constrictions of China's still-planned economy. (O)
- Give enterprises **tax preferences**.
  - FDI had to be **joint ventures**.
  - Idea is to lure overseas Chinese investors. Easier to do business in SEZ.
  - Example, **Foxconn**. The Taiwanese company that assembles i-phones in Shenzhen

## Policy Reversal

- Deng's Southern Tour: **Socialist Market Economic System**. Deng was saying that economic reforms were good. The top leadership made it official and endorsed the socialist market economy system, meaning the market mechanism would extend to the entire economy.
  - SOE downsizing, restructuring. Focus on profitability
    - The SOEs were money losers. They were either privatized, allowed to go out of business, merged with other SOEs.
    - SOE sector downsized (SOE employment falls by 40 percent).
    - End of the Iron Rice Bowl.
  - Joint venture FDI—to learn the technology
  - Build exports through Special Economic Zones, then the WTO.
  - Dismantled dual-track system
- Emphasis now on **urban** areas, and SOEs.
- Rural enterprises starved of financing, driven out of business. (details in Huang chapter 3)
- Floating migrant population  
<https://www.youtube.com/watch?v=VqYBjoGmNQs>
- Embracing globalization and trade. Ascendancy to the World Trade Organization.



## TVEs vs SOEs

- Leadership viewed TVEs as **competition** to urban SOEs. SOBs stopped lending to TVEs. Suppression of rural enterprise.
  - Chinese state began to systematically stamp out those providers of capital outside the state banking system. The government began to curb the operations of nationwide semi-official financial institutions, rural cooperative foundations (RCFs), in 1993 and completely banned their operations in 1998.
  - Story of illiterate housewife in Wenzhou, **Zheng Lefang**, executed for financial fraud. Also **Sun Dawu**, rural entrepreneur of animal feed company. Refused to bribe bank officials to get funds. Turned to employees of his company and asked them to contribute funds. This practice, widespread in the 1980s was legitimate source of start-up capital for many TVEs. But this time, Sun was arrested and thrown in prison.

## From Entrepreneurs to Laborers

- For peasant to earn more, he can (i) start own business, (ii) become paid laborer. Slowdown of rural income caused them to go to urban areas to work as laborers.
- Tightening credit constraints kept private businesses and TVEs from expanding, created fewer job opportunities, and increased flow of migrants. This caused **explosion of rural migration**. The **floating population**.

## Financial Liberalization in the 1980s.

- In 1980s, growth of Rural Credit Cooperatives (RCCs), permitted private players to enter. This was central policy making. Pioneer of financial reforms of 1980s was the ABC (Agricultural Bank of China). ABC and RCCs should and did provide loans to rural residents to engage in non-farm activities.
- RCCs were the most important financial institution in rural china.
- Informal finance was tolerated and flourished.
- Another institution, called rural cooperative foundations (RCFs), organized by villages.

## Financing Repression of the 1990s

- Started right after Tiananmen. Conservative leadership mounted assault on private sector. Political assault on private sector ended after the Southern Tour. After that, the financial repression was not political, but technocratic ideology.
- Lending priorities of SOBs changed. Support agriculture, not rural entrepreneurs. Crackdown on informal finance because it competed with the state's industrial policy.
- Surviving TVEs rely on **self finance**. Partly responsible for the saving boom.

## Macroeconomic reforms

- Inflation told leaders to upgrade monetary institutions.
- Tightened macroeconomic policy.
- SOEs had to be profitable or they'd be shut down or privatized.
- As state gives up control over resources, revenues decline. How to raise resources?

# Regulatory and Institutional Restructuring

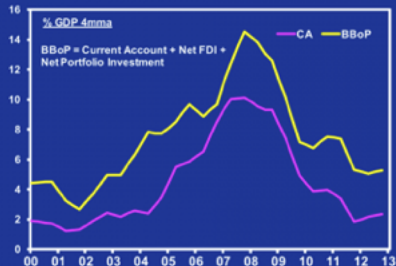
- Dual-track system out. SOEs integrated into market system, real profits and losses.
- Banking and Financial System
  - People's Bank of China (PBOC) given a central banking charter (1995) to conduct monetary policy, oversight of SOBs.
  - Address problems of SOB lax financial supervision and non-performing loans.
- Corporate Governance
  - SOEs reorganized as limited-liability corporations, and getting listed on stock market.
  - Create financial regulation platform.
  - SOE sector (and employment) significantly downsized
- Embrace Globalization
  - Efforts to open the economy begins in 1993.
  - FDI allowed, through joint ventures.
  - Undertook broad range of reforms to harmonize with international standards with eye towards admission to WTO
- Reform with Losers: SOE workers. Unemployed! Thrust into a labor market. Loss of Iron Rice Bowl

# Ascension to WTO—Trade explodes



Asset  
Management

## China BBoP and Current Account Surplus



Source: Haver Analytics and GSAM calculations

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## Ascension to WTO—Trade explodes

- Chinese harmonization with international standards and institutional convergence.
- Removal of export subsidies to steel, wood products, IT, and others
- Import liberalization (tariff reductions from 31.5 to 14.5)
- Allow foreign firms to sell directly in Chinese domestic markets (previously had to go through Chinese trade organizations)
- Open telecommunication and finance sectors to foreign competition. Allow foreigners to own shares in telecoms and banks.



## China's value-added to i-phone

I-phone 7: \$8.46. Billed as import of \$240. Retail price \$649

# Institutional Reform

- Before: Local governments made money through their TVEs. Policy reversal caused firms to move to cities.
- After: Merit and promotion of party members based on GDP growth.
- Local competition for development, deal making, land development. Generates high investment
- Unintended consequences.
  - Pollution externalities  
<https://www.youtube.com/watch?v=2nFZaSbkf0U>  
<https://www.youtube.com/watch?v=k1JGGjAm42c>
  - Land grabs:  
<https://www.youtube.com/watch?v=rB08UL-INXA>
  - Real estate investment, ghost cities  
<https://www.youtube.com/watch?v=Ie6zd3Rwu4c>
  - Floating population, internal migration, urbanization  
<https://www.youtube.com/watch?v=9VN5A5pShXo>  
(China Uncensored)  
<https://youtu.be/VqYBjoGmNQs> (11 minutes)  
<https://www.youtube.com/watch?v=KNXg-kYk-LU>  
<https://www.youtube.com/watch?v=zckwMlhtSi0>  
<https://www.youtube.com/watch?v=H2eHKVLQkxU&t=64s>
  - Left-behind children  
<https://www.youtube.com/watch?v=22cDgXj6K98>
  - Migrant children. Hukou.  
[https://www.youtube.com/watch?v=\\_c1X1WACZ6Y](https://www.youtube.com/watch?v=_c1X1WACZ6Y)