

**THE REFORM OF THE CHINA'S ECONOMIC SYSTEM:
A SOLID BASIS FOR OVERCOMING THE CRISIS**

MICU Liviu Alexandru

¹Economics Faculty, Academy of Economic Studies, Bucharest

Abstract.

This article presents in a chronological order the reform of China's economic system and underlines some of its particularities. Which in my opinion make the whole Chinese economy unique. I considered mapping the gradual economic change and how it has transformed China in the last 30 years, from a country in which 30-40 million people starved to death (under Mao) into one of the few countries that could treat the economic crisis as an opportunity, as being that which defines my article.

Keywords: *economic system, private property, system contract, reform*

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1. Introduction

At the present time in China lives a quarter of the Earth's population and at the time when the Europe was still in the Middle Age, it was by far the most advanced civilization of the world. Nevertheless, for 500 years its development has stagnated, placing it so in many respects behind the rest of the world. But, all these are changing at a surprising speed, until now no other emerging country has registered the volume of foreign investments China has benefited from in the last twenty years, nor has any other country had at its disposal a labor force of such proportions it can use for such impressive scopes.

From many points of view, the large Chinese labor force could be described as the most valuable resource in the world. Maybe this country does not have a plenty of natural resources (fact proved, in my opinion, by the desire of the Chinese authorities to contract natural resources from zones such as Africa, Brazil and Russia), but it has billions of hands able to toil at minimum costs. The key of China's ascension has been and, will continue to be in the future, this large labor force with an unusually high mobility, "about 200 million

of workers have invaded the urban zones coming from the rural zone whenever a labor force has been needed for keeping the factories running, contributing considerably to the development of the cities by building blocks of houses, spectacular office buildings or even Olympic stadiums” Farndon (2008). Without these workers, frequently neglected and underestimated, the Chinese economic miracle wouldn’t have been possible.

2. The gradual changes of the system, accompanied by incursions in history

The Chinese economic system has been significantly changed in time through authentic revolutions done at the level of the State policy. The changes have began with a disaster represented by the ”Great Leap Forward” Xiaobo (2010), the policy of Mao Zedong between 1958-1961 promised China a rapid leap into a prosperous future. In August 1958, the Political Bureau of the Communist Party has decided that private property over the land must be abolished, trying to transform the peasants’ farms into efficient agricultural units. The peasants have been moved out from their homes and enlisted into production brigades and teams where they were made to work without payment for the labor units. The children had to be looked after separately, while their parents were living and working in common. All these have culminated with a plan to move all the people into large dormitories and feeding them in canteens, but this idea was dropped pretty fast, due to strong opposition. At the same time Mao has initiated a plan of increasing the industrial production through a common effort. ”The production of steel, coal and electricity had to be increased by more than a third each year, so that, Mao argued, after 10 years the industrial production of China should be comparable with that of Great Britain and after 15 years would surpass that of the USA” Farndon (2008). Mao’s economic system was sustained by millions of seasonal workers co-opted to build large plants, to dig channels and to drain swamps. The main objective of the system proposed by Mao was that each collective have its own steel mill to produce steel from scrap metal.

The result of the Maoist system was ”the Great Leap Backward”.

In reality when the agriculture was fully turned into a collective, it transformed into a catastrophe, ”the low productivity per hectare bringing with it a famine that has led to the death of 30 to 40 millions Chinese people.

The industry didn’t do better either, more than 98% of the initiated industrial projects being doomed to fail” Zhongqing (2003). The focus onto

steel production meant that all the other industries underwent difficulties, this led to a decrease of China's industrial production by a half between the years 1958 and 1959.

In these conditions even Mao had to admit that his plan failed and he resigned from the position of Republic president, leaving the office to Deng Xiaoping, while Zhou Enlai became the prime minister.

Mao has, nevertheless, remained the president of the Communist Party but it was just a matter of time before he came back.

Alongside with his resignation and the appointment of Deng Xiaoping as president, the economic strategy of the party has been modified, allowing a larger liberty to the individual entrepreneurs. With the help of the economist Chen Yun significant changes were registered in enterprise management, these being ran by authentic managers and not by bureaucrats like they were during the Mao's term of office, and the agriculture, the main field of interest, given its weight in the GNP, got onto the right track again, being propelled simultaneously with the liberties given to the small farmers.

"This set of measures has made the Chinese economy look better during the 60's. But Mao hadn't played all his cards yet, coming back into the spotlight together with his Proletarian Cultural Revolution" Farndon (2008).

If Mao had generated a shock to the Chinese economic system by his program "The Great Leap Forward", the Proletarian Cultural Revolution was an even greater shock. Mao's official intent was to rid the country of bourgeois ideas and to reignite the communist zeal through the mobilization of the country's youth, but it was clear that, at the same time, he wanted to get rid of his opponents within the party. Stimulated by Mao, the students of the Beijing University have begun to protest against the officials and the government who, they alleged, were bourgeoisie people.

When Liu Shaoqi tried to calm things down, Mao immediately launched a stinging public attack and guided the students to organize their own political militia, the Red Guard. At the same time, Mao's supporters encouraged the development of Mao's personality cult by distributing copies of his quotations from the "The Red Book".

The Red Guard had extended its units beyond expectation, the schools and the universities have been closed while the young members of the Guard went on in the streets to fight against The Four – old ideas, old culture, old habits and traditions. The Academies were assaulted, books burnt, temples and monuments attacked, shops selling Western products were burnt to the ground and the

gardens of the bourgeoisie people destroyed. The high ranking officials, Deng Xiaoping included, were driven out of the public institutions. Tens of thousand people had been beaten, abused, killed or led to suicide while the campaign went on. When the factions of the Red Guard began to wage war against each other, and the country was ruled by chaos, Mao finally gave in to the pressure. He sent the army to take control and gathered up millions of young members of the Red Guard whom he sent to the countryside in order to transmit the communist message to the rural people.

In 1969 Mao was reelected with great pomp as President of the Republic, and Lin Biao was appointed as his successor. Lin was the personal choice of Mao and his best student but, nevertheless, he immediately rose against Mao, plotting unsuccessfully to assassinate him.

During the Cultural Revolution a figure, nevertheless, has held out: Zhou Enlai. It is considered that he used his influence in order to moderate the most negative effects of the Cultural Revolution. Also, it is thought that he was behind the new movement oriented towards friendship with the U.S.A., which has culminated with the famous visit of President Richard Nixon in 1971 and 1972 in China, fact contributing to the acknowledgement of the Chinese state by replacing the Taiwan at the United Nations. Zhou Enlai thought that for China it was essential to occupy an important place among the world's states and to get equal status through a real internal development, involving modernization in four fields: agriculture, industry, science/technology and defense.

Mao attacked Zhou by accusing him that had a right-hand orientation. Zhou has survived the attack, but in 1973 he was diagnosed with a serious form of cancer. With the agreement of Mao, Deng Xiaoping overthrew Zhou and continued the four modernizations. But when Zhou died in January 1976, Deng was exposed to attacks full of insults from the four important figures of the communist party known as the Gang of Four - Jiang Qing, Mao's wife, together with Wang Hongwen, Zhang Qunqiao and Yao Wenyan. Deng was dismissed from all official positions and Mao chose the relative unknown Hua Goafeng to become the prime minister. For more than a month it has been thought that the Gang of Four will overturn all the Zhou's reforms. But on the 5th of April 1976 two million people gathered in the Tiananmen Square in Beijing in order to keep a moment of silence for the death of Zhou Enlai, and the meeting transformed into a protest against the Gang of Four.

On the 9th of September, in the same year Mao died and Hua became the president of the party and together with Deng and, the support of the army, he arrested the Gang of Four. Two years later, in 1978, Deng succeed to climb his way back to the power and together with Chen Yun he conceived a new economic strategy meant to revive the system. So, starting with the year 1978, the collective farms were broken apart and the land was given back to the small farmers which were allowed to grow whatever they wanted and were free to sell the surplus.

The results did not delay to show; the Chinese farmers having control over their own farms, made the cereal production increase by a third between 1978 and 1984, and, more than that, the quality and the variety of products in the Chinese farms have increased dramatically. With the money received from selling the surplus, the farmers even succeeded in starting up small business.

The founder of the special economic zone from Shenzen Yuan Geng has said: „Time is money. Efficiency is your lifeline” Xiaobo (2010) – his motto spread throughout the country and became a symbol for the changes in China.

The movements of capital and human capital taking place in the province of Shenzen have led to economic changes of huge proportions ”the city being transformed from a fishermen’s city into a highly industrialized one” Xiaobo(2010) and the legal framework inexistent at the beginning of the year 1978 as far as the market regulation was concerned, has allowed to the businessmen from this zone to accumulate up great fortunes in a very short period of time, even if the most of time this was based upon activities such as: illicit work, falsifying income statements or double-entry bookkeeping. And, of course, the lack of regulation of the market has allowed them to carry out all types of rent-seeking activities, which earned them the title of ”Masters of the art of reselling”

The basic cell of the economic system in China began to regenerate itself in 1979, with the regulation of the market starting. When for the first time in China the ”State Administration of Foreign Exchange“ was founded, with the purpose of monitoring all the transactions with the abroad. Another successful initiative by the leadership of that time was the founding, in the same year, of “China’s Enterprise Management Association” which included the department of C.C.T.V., the first advertising department in China and which 20 years later became „China’s most powerful ad agency” .

At the same time in Shangai, some of the ex Chinese businessmen gathered funds for what became ”Shanghai Municipal Industrial and Commercial

Construction Company”, subsequently being known in China as ”People-Operated Enterprise”.

All these institutions were the basis of a revolutionary system that transformed China in only 30 years into the second worldwide economic power; all under the influence of the communist regime; which applied in other countries has led to disastrous economical results (Russia, North Korea, Cuba, etc.).

On 15th March 1979 Wenhui Bao, an important newspaper in Shanghai has published an ad for the Swiss watches company RADO. At the same day the TV station in Shanghai has broadcasted an English spot for RADO with Chinese subtitles. Even though few people understood the message of the ad, given the fact that the people were used to usually seeing on TV odes dedicated to the leaders rather than advertising spots specific to a capitalist system, only 3 days later more than 700 buyers asked about the RADO watches at its representative agency in Huangpu.

In 1979 an economist from Hong Kong, Steven N.S., has asked himself if China will follow a capitalist way. ”I do anticipate that in the future China will adopt a structure of property similar with private property. I can categorically affirm that in the future China will allow in a large measure rights of use and rights of transfer for things such as: labor, means of production, buildings and even land” Xiaobo (2010).

Another thing said by the economist Steven N.S. was the fact that, even if China will, in the future, allow the transfer of resources and the right of private use, it will not ever describe its economic system as being capitalist or one that allows private property.

Ten years later Steven became well known for his very accurate predictions and by the year 2000 the term ”private property” became a publicly admitted term in China.

In 2004 the legal protection or the legitimacy of the right to own private assets has been introduced officially in the Constitution of the ”People’s Republic of China”

China’s road of reforms had ups and downs. Whenever the reform had problems, all kind of contradictions have arisen, both old and new, allowing history to make various ”adjustments”. Nevertheless, the entire economy of China has demonstrated a remarkable force of regeneration.

3. The reform of the State companies

A learned man from Hong Kong has visited Shuangzu in 1979 and he spoke about China's future, amazed by his own experiences he had there. He spoke about the low efficiency of the State companies in China "where all the people consider themselves to be in charge and, at the same time, nobody assumes any responsibility" Zhongqing (2003). Such a behavior was the result of the authorities' attitude; they promoted a planned economy in which the State companies were protected through subsidies, at the same no long term vision for the future of these companies existed.

Also, the State controlled all of the manufacturing process and the allocation of goods, also establishing within such a context the price for goods and assets. Any State company being just a unit within the system of planned economy. The leaders of those companies were managers in name only, they were appointed based upon political criteria, the companies were not equipped to cope with competition, having just a position of monopoly, following the economic path of the country and integrating themselves perfectly in an economic system that has generated numerous problems from the social point of view.

The managers of these State companies have implemented a system based on complex personal relationships between the people at various levels of management so that their reform was unimaginable. Nevertheless, a first step towards the reform of the companies has been made the moment the political decision-takers considered the extension of their autonomy in taking decisions as being beneficial.

„So, in May 1979 „the State Council” has announced that eight large State companies will be involved in an experimental process of extending their autonomy. Among those 8 companies were: Capital Steel, Tianjin Bicycle Factory and Shanghai Diesel Engine Plant.

In July 1979 five documents were released at the same time with regard to the extension of the decision-taking power for these companies” Xiaobo (2010). Measures concerning the increase of the return rate, the improvement of using the return quota, the change of the taxation of the fixed capital and the fact that the government has offered crediting loans rather than subsidies for the improvement of the circulating capital represented a good start on the sinuous road towards reform of the State companies in China.

Many economists have tried stubbornly to solve the problem of reforming the State companies but this only occurred a couple years later when

they have concluded that the fundamental essence of the problem had all the time been the clarification of the property of assets. Nevertheless, many years had to pass in order for the State companies that had a position of monopoly on the market (being artificially sustained from the budget) to become the most profitable companies in China.

The problems concerning the reforming of these companies in the first years of the experiment were rapidly made evident. The company Capital Steel hired „200000 people but the manager did not succeed in making significant reforms” Ritzer (2010).

After a period of time the company Capital Steel, aiming at a larger autonomy in taking decisions, proposed ”the system contract”. The system contract proposed that all products above the basic production necessity of the State, be managed by the company, following that the losses and the profits generated be managed also by the company own account, increasing in this way the company’s autonomy.

In the 70’s and 80’s when a major unbalance existed between the supply and demand the factories occupying a monopoly position were rapidly selling all they produced, Capital Steel had an ever greater profit and the authorities began to ask more and more money from it. ”The tensions between the plant management and the State authorities regarding to who was supposed to receive what percentage amplified until ”December 1986 when the Municipal Government from Beijing issued an order by which Capital Steel was obliged to pay an amount of 108.99 million RMB from its profits and the factory management refused to cooperate. The manager of Capital Steel sent a letter to the State Council and also to the president Deng Xiaoping, stating that ”If I am to give the requested amount all the technological improvements being made would have to be stopped, the benefits received by the employees would have to be postponed and new funds will be needed for the payment of the employees’ bonuses, received according to their performance. And, more than that, we will be unable to pay the employees hired during this month”.

A month later, Deng Xiaoping has issued a presidential note through which he announced that all the contract terms with the Capital Steel enterprise remain unchanged” Farndon (2008)

This Capital Steel episode was generated by the competition between two groups with different interests regarding this State company. This kind of problems subsequently showed up in almost all the State enterprises from that time period. In this way, it was rapidly acknowledged that although the system

contract worked well in regard to the increase of productivity, there was no clear delimitation of property and the benefits of the right to private property and, therefore, there was no way to solve the conflict with the State authorities.

On other hand, this type of "system contract" could not allow the State company to spend money without somebody accounting for it in the same way as for a private company.

During this period of time dominated by the appearance of the system contract, the investments made by the State companies have significantly increased but a part of this money have been oriented towards "business outside the Plan" Xiaobo (2010)

The expenses generated by the investments have been impossible to control because nobody was made assume responsibility for the failure of these investments. Consequently, "the profits have been pocketed and the losses were seen as being someone else's problem" Zhongqing (2003)

And when it came time for some one to pay the bill for these expenses, everyone turned to the state. Noticing the attitude of the management of State companies, the central government decided to adopt a definite position on the matter by reforming the system of fees and taxes. The first major step in transforming the State companies into modern companies with corporative governance was "Changing profits to taxes". In this manner one desired to free the companies from the paternal system "one big pot", even if this was only a timid approach, the profit taxing system proposed by the central government registered results in the long term. Looking back objectively, the reform of the profit taxing system contributed to both the amelioration of the conflicts between the companies and their managers and also created a favorable framework for the development of the State companies, companies that in a short period of time have succeeded in getting real performances.

Nevertheless, the inherent problems of the economic system have not been solved through this reform, the fiscal categories being strongly uniformed so that the new fiscal code could not be used as a regulating instrument at macroeconomic level and the allotment of the net profit continued to be an extremely painful problem, they being preponderantly directed towards certain groups of interest.

More important is the fact that this reform of the taxes and fees system was not meant to solve the problems of the State companies profoundly indebted and suffering from large losses and did not set any rules concerning this aspect.

The State companies have continued to represent black holes in China's budget from that period of time and the reform done in the field of taxes and fees did not solve more than a handful of the problems these companies were facing.

The reform of the State companies has continued for more other 20 years, nobody volunteering to solve the delicate problem of private property until the year 2006. As a consequence, the State companies were further on emaciated, therefore generating a favorable medium for the development of private companies, as we can see in Table 1.

Table 1: The General Development of Private Enterprises

Year	Privately-run Enterprises			Individual Businesses			Total Employees in Private Enterprises (million persons)
	Heads (millions)	Registered Capital (billions RMB)	Employees (million persons)	Heads (millions)	Registered Capital (billions RMB)	Employees (million persons)	
1978				1.83	0.50	0.14	
1981	0.091	8.40	1.64	12.47	34.70	2.27	21.42
1989	0.098	9.50	1.70	13.29	39.76	21.04	22.74
1990	0.11	12.32	1.84	14.17	48.82	22.58	24.92
1991	0.14	22.12	2.32	15.34	60.10	24.67	26.99
1992	0.23	68.03	3.72	17.67	85.49	29.39	33.12
1993	0.43	144.80	6.48	21.87	131.90	37.76	44.24
1994	0.66	262.20	9.56	25.29	168.90	46.14	55.70
1995	0.82	375.20	11.71	27.04	216.50	50.17	61.88
1996	0.96	514.01	13.49	28.051	257.40	54.42	67.91
1997	1.20	1020.10	17.09	31.20	312.03	61.14	78.24
1998	1.51	1028.70	20.22	31.60	343.90	62.41	82.63
1999	1.76	1330.80	24.07	25.71	331.50	50.70	74.77
2000	2.03	1821.20	27.14	24.33	343.60	47.60	74.74
2001	2.44	2475.60	34.09	23.78	378.20	47.43	81.52
2002	3.01	3630.50	42.99	23.53	418.70	46.37	89.36
2003	3.65	4793.60	50.17	23.51	505.80	45.87	96.04
2004							
2005							
2006							

199 7							
199 8							
199 9							
200 0							
200 1							
200 2							
200 3							
200 4							

Source: Statistical Yearbook of China, 1990-2005; Yearbook of State's Industrial and Commercial Administration, 1992-2005

The Chinese economic system seen through the eyes of the Western people has a big weakness, namely the maintaining the right to property at the same time with maintaining a rate of economic increase generated largely by the afflux of direct foreign investments that have reached a record level.

But the private property is a taboo subject for the traditional communists, fact that led, at the moment of introducing the law for the first time in the party in the year 2006, to protests from the left-hand conservators, they considered it as being the last in a long line of numerous treasons to the communist ideals made by the reformist leaders.

The fact that the government succeeded to win the debate or that somebody has simply thought to propose such a law, is proof not only of the level of influence the economic reformists from the leadership of China have but, also, of the huge force of the economic boom that seems to destroy any opposition, making any opposing arguments irrelevant.

The rhythm of the economic progress generated by the changes in the system at the same time with the approval of the law concerning the protection

of the right of property was an amazing one. Although in certain fields the profits registered by China are certainly exaggerated by the authorities' desire to demonstrate the superiority of the system it represents. The redirection of the funds from the eastern regions that are in full economic swing towards the poorer western regions has led to a dominant trend of under evaluating the situation because the prosperous regions report smaller figures so that they do not lose too much from the funds given from the centre and the stagnant regions, also are report smaller figures in order to demonstrate how much they are in need of financing.

"The level of government's frustration towards this type of manipulation is pointed out by the fact that in 2003 it has sued for fraud more than 20,000 clerks suspected of falsifying the registries.

And even the clerks are of an exemplary moral integrity, they only have at their disposal the figures supplied by companies famous for double-entry bookkeeping and other ways of altering the registries. Besides these aspects, there is a huge underground economy comprised of unauthorized or even illicit businesses" Farndon (2008)

Given these conditions it is very possible that after all the official estimations concerning the proportions of the Chinese economy are much smaller than they are in reality.

"Another way through which the Chinese economy is under evaluated is its currency, China maintaining the Yuan at a fix level against the American dollar instead of allowing to fluctuate as it happens with other currencies" Ritzer (2010)

All of these peculiarities make the Chinese economy one which challenges the economists in their quest to identify the strenghts of the Chinese economical system which can then be succesfully transfered into other economies.

4. Conclusions

Thusly, in the course of history, the reforms meant significant changes which resulted in the reinforcement of the Chinese economical system:

- transferring of the agricultural land from the State's property into private property, during the time when agriculture was a large part of the GDP;
- changing from working the land into a collective (Mao age) to the emergence of the small farmers and then to the mass production agriculture;

- the founding of some authorities which regulated the market during the communist regime, like the “State Administration of Foreign Exchange“, China’s Enterprise Management Association, People-Operated Enterprise;

- the reform of the State enterprises starting from the issuance of the “System Contract”, switching from enterprises protected by subventions, with poor efficiency to autonomus enterprises which shortly became profitable and then internationally renowned for their performance;

- insertion in the Chinese Constitution, in 2004, of the right to own private assets, and subsequently of the idea of ”private property”.

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