China - Economy in Transition

Rezumat

China este în mod cert un exemplu de succes pentru reforma economică realizată în mod gradual. După mai mult de doua zeci de ani de tranziţie, agricultura şi întreprinderile de stat sunt încă ineficiente şi constituie încă un subiect de dezbatere. Devenind membru al Organizaţiei Mondiale a Comerţului, sectoarele ineficiente ale economiei Chinei vor deveni vulnerabile în cadrul comerţului internaţional. Acest articol prezintă impactul - pozitiv şi negativ - al măsurilor de reformă economică adoptate recent în domenii precum agricultură, întreprinderile de stat, sectorul privat, politica porţilor deschise. Sunt analizate: clarificarea drepturilor de proprietate şi a problemei acţionariatului, a structurilor noi organizatorice, politicile de sprijin guvernamentale. Organizaţia Naţiunilor Unite demonstrează ca aceste măsuri de reformă au avut un impact pozitiv asupra economiei chineze, dar este necesar ca acestea să continue, prevenind producerea unor efecte negative.

History and culture (a summary)

China is the largest country in the world in terms of population (1.29 at the end of 2000), the third largest country in the world in terms of land area (after Russia and Canada). Over 90 per cent of the population are Han. China has to support about 22 per cent of the world population on something like 7 per cent of the world's arable area. China is an ancient and continuous civilization, its history can date back to 4000 BC.

China's social basic ethics is Confucian and this influences Chinese culture and social activities. In this regard, three positive value central to the Confucian system of ethics are of particular interest. Loyalty, reciprocal obligation, and honesty in dealing with others. For example, loyalty to one's superiors binds employees to the heads of their organization, but the superiors are obliged to reward the loyalty of their subordinates by bestowing blessings on them as well. That's why lifetime employment is very popular in China. Honesty has also major economic implications - when companies can trust each other not to break contractual obligations, the costs of doing business are lowered, because they are not to violate the terms of their agreement and thus expensive lawyer are not needed to resolve contract disputes.

The same influences also are very important if we try to explain many negative phenomena in China:

(1) It was also the loyalty to the superior that led to the Great Leap Forward (1958-1959) and the 10 years of Cultural Revolution (1966-1976). When the highest superior summoned the Great Leap Forward and the Cultural Revolution, very few people doubted it, they adored the highest superior, they thought what he said was always right. So during the Great Leap Forward in an attempt to accelerate economic development and learning the lessons of Soviet Collectivization of the 1930s' transition to Communism, 'people communes' were set up. Pronounced moves towards egalitarianism severely dampened work incentives and the removal of peasants from the land to work in local industry (' backyard steel furnaces', etc) were factors that contributed to drastic falls on agricultural output and massive losses of lives. During the 10 years of Cultural Revolution, almost all of the Universities teachers and other higher educated people were sent to the farm courts, the Universities almost closed around 5-6 years. Chinese economy was at the margin of bankruptcy. It was a disaster both for Chinese and for the world economy.

(2) The second negative influence is conservatism. Chinese adore their long-existing civilization. This leads to conservatism, which causes that many Chinese accept new cultural and new things with more difficulty than others.

Economic reform

1. The characteristics of the Chinese approach to economic reform

It is generally recognized that China had no detailed blueprint for economic reform in 1978. Deng Xiaoping used to describe it as "crossing the river by feeling for stones at each step". Its economic reform policy is gradual and partial and it is called "soft landed'', in contrast to the compared 'big bang' or 'shock therapy' in countries of Eastern Europe and the former Soviet Union. Chinese economic reforms are described as "planned socialist commodity economy¡± has given way to " socialist market economy". Now the reforms have proceeded and ideological concessions have become more and more accepted.

2. Agriculture

a) Household Responsibility System (HRS). Agriculture was the first sector to be reformed in 1978 and the reforms were rapidly introduced to the whole country. Private (family) farms do not own agricultural land (it is owned by the village community), but are allowed to lease land. Originally, leases of three to five years were common, but the length has been increased substantially. From the last year on the revised Land Management Law stipulates that land-use leases for farmers nationwide should be at least thirty years, but can be even longer (fifty years), leases are inheritable and peasants have subsequently been allowed to lease land to one another. Family farms are 'responsible' for meeting quotas for specified products and tax obligations, and payments for collectively provided services. But the more important fact is that the private farms are free to determine their own output and to whom to sell at market prices.

(b) Results: successes and problems

Successes: The boost to incentives and other factors led to a remarkable improvement in farm incomes, the United Nations (World Economy Survey, 1993, pp, 187, 197) estimates that rural incomes were increasing at an average annual rate of 12.8 per cent during 1978-1985.

Problems:

First, since mid-1980s things have not been so rosy and there has been considerable peasant discontent in resent years, e.g. complaints about the prices they received for output and have to pay for inputs as well as taxes and charges imposed upon them by local authorities (in many cases illegally). The gap between rural and urban incomes has widened considerably to detriment of farmers. In recent years, for example, per capita income rose 8.7 per cent in urban to 3,208 renminbi in the first half of 2000 while rural per capita income rose just 1.5 per cent to 1,013 renminbi (FEER, 24, August 2000 p. 57). For this reason, there is now a huge 'floating population' in the town and cities as farmers have left the land to seek work in the cities, 'Nobody knows exactly how many economic migrants there are, but the number is huge: estimates range from 80 million to 130 million' (the Economist Survey, 8 April 2000, p. 15).

Second, inadequate invest in the rural infrastructure, such as irrigation and flood control etc, because of private incentives now dominated.

Third, Land is distributed relatively equally and the average farm is divided into plots, which makes mechanization difficult, so now many farmers begin to amalgamate the family plots in farms of shareholders.

3. The market economy gradually replacing central planning

China is an example of successful policy of gradual and partial economic reform, successes have been achieved on a broad front, in terms of such criteria as output growth, living standards, poverty reduction and inflation.

The date in table 1 tells the basic story.

Table 1

Economic indicator	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
Rate of growth of GDP (%)	*3.8*	*9.2*	*14.2*	*13.5*	*12.6*	*10.5*	*9.6*	*8.8*	*7.8*	*7.1*	*8.0*
Rate of growth of industrial output (%)	*7.8*	*12.9*	*20.8*	*23.6*	*18.0*	*13.9*	*12.1*	*10.8*	*8.8*	*8.5*	*11.4*
Rate of growth of agricultural output (%)	*7.6*	*3.0*	*3.7*	*4.0*	*3.5*	*5.0*	*5.1*	*3.5*	*3.5*		
Grain output (million tones)	*435.0*	*435.3*	*442.6*	*456.4*	*444.5*						
Retail inflation rate (%)	*2.1*	*2.7*	*5.4*	*13.0*	*21.7*	*14.8*	*6.1*	*1.5*	*-2.6*	*-2.9*	
Population (billon)		*1.158*	*1.17*							*1.259*	

Source: IMF. United Nations. OECD.

a) The state owned enterprises (SOE)

Since the beginning of the 1990s, polarization has speeded up among state-owned enterprises. Some have gained robust growth and continuously expanded their market shares, while the less competitive ones have found that the going was getting increasingly tough. Some of these enterprises have begun to call for changing their ownership system. First, their financing channels have been diversified, so that competitive enterprises could either attract capital from other enterprises by introducing the share-holding system or raise funds by becoming listed companies, or directly absorb foreign capital. Progress made in commercializing the banks has also promoted banks to pay more attention to the quality of loans rather than the forms of ownership of loan-receiving enterprises. Secondly, with the worsening of financial conditions in most state-owned enterprises and with the number of loss making enterprises on the rise, the government has adopted a tough attitude towards them. So, the value of their state-owned status is quickly declining, it is to say, with the ripening of the market mechanism the state ownership has become a low efficiency form of ownership for some enterprises.

By contrast, non-state enterprises, especially share-holding enterprises and foreign-invested firms, have shown their strength in management mechanism and policy environment.

b) The non-state, non-agricultural sectors

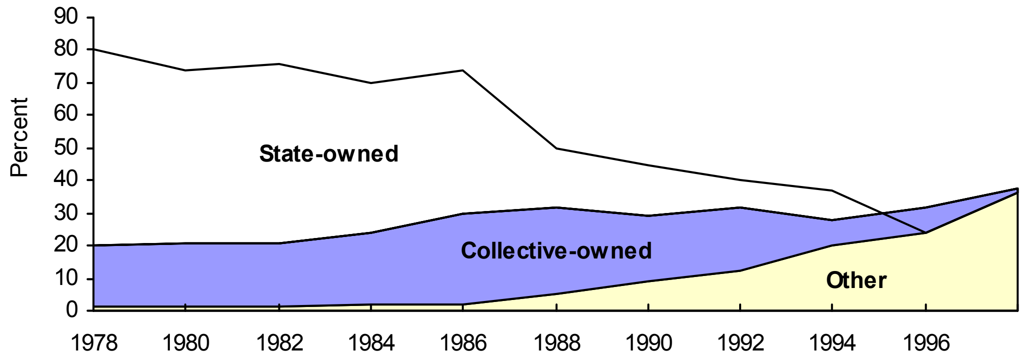
A basic feature of the Chinese approach to economic reform is the emphasis on encouraging the non-state sector to grow and thus provide competition for the state sector, as suggested by the ‘evolutionary theory’. Now the privatization of small state enterprises and even some medium-sized ones has been more in vogue in China recently.

The non-state sector includes:

A. Foreign-joint ventures, Special Economic Zones
B. Collective, mainly “township-village enterprises (TVEs)"
C. Private sector

În 1978 the state sector accounted for 78 per cent of industrial output, but as the competitiveness of the non-state enterprises surged, only about half of the state industries were able to meet the challenge.

During the period 1980-1997, the state’s share of industrial output fell from 76 per cent to 25.5 per cent, while the collectively owned enterprises saw their share increase from 23.6 per cent to 38.1 per cent. ‘Other’, including private firms and foreign joint ventures, increased from 0.5 per cent to 36.4 per cent. See figure 1:



Source: State Statistical Bureau, Statistical Yearbook of China, China statistical Publishing House, Beijing

Figure 1

The weaknesses of TVE have emerged in the recent years, in terms of the manager’s short time horizons, local corruption, low-tech, low-capital, low-skilled labor etc. All of the problems make it difficult for many of these firms to upgrade quality, move into higher-value types of manufacturing and increase their scale of production. The TVEs also face problems caused by interference by local governments and lack of personal responsibility for failures. In order to improve some of the TVE’s internal drawbacks, to define the property rights, to improve the incentive system and democratic management, strengthen the role of entrepreneurs and to attract scarce resources, many TVEs have transformed themselves into ‘shareholding cooperation’ since 1988. The main idea behind the ‘share-holding’ is as follows: workers have preferential right to buy the shares, profit is distributed according to one’s shares, the shares are not legally transferable.

At the end of 1997, the Ministry of Agriculture issued ‘proposals for expanding the reform of township enterprises‘. As a result, China has started to experiment with such alternative forms as joint stock companies and shareholding co-operatives, as well as mergers, outright sales and bankruptcies. Other approaches that have been used in small enterprise reform including auction or sale to private investors and joint ventures with domestic and foreign investors.

Now many large rural enterprises have formed enterprise group or converted to joint stock limited liability companies, large firms are being encouraged to form enterprise group with both other rural enterprise and entities with different ownership forms such as private firms, local SOEs and research institutions like universities. In addition, a large number of larger rural enterprises have been converted into joint stock or limited liability companies in which each shareholder’s liability is proportionate to his/her investment. According to the statistics, there are 1.5 million private enterprises that employ 130 million workers and contribute to over 50 per cent of the GDP.

While recent reforms have brought a range of benefits there are still a number of problems: in some instances workers have been forced to invest their savings in purchasing shares, in some cases local government continue to exercise tight control over the appointment of managers, etc.

4. The ‘open door‘ policy : foreign trade and foreign direct investment

În 1978 the policy was announced of opening up the economy to foreign trade, capital, technology and know-how in order to modernize and speed up the growth of the economy.

a) Foreign trade

The importance of foreign trade to the Chinese economy has increased substantially and China climbed in the world rankings of exporters from the 32nd place in 1978 to the 7th place in 2001 (not including Hongkong , Taiwan and Aumen). The table 2 and figure 2 tell you the basic story.

Import & Exports During 1990-2000

Table 2

	USD 100 million			Change over 1978 (times)		
Year	**I & E**	**Exports**	**Imports**	**I & E**	**Exports**	**Imports**
1978	206.38	97.45	108.93	-	-	-
1991	1357.02	719.10	637.91	5.6	6.4	4.9
1992	1655.25	849.40	805.85	7.0	7.7	6.4
1993	1957.03	917.44	1039.59	8.5	8.4	8.5
1994	2366.21	1210.60	1156.15	10.5	11.4	9.6
1995	2808.63	1487.80	1320.84	12.6	14.3	11.1
Total of last 5 years	**10144.14**	**5184.34**	**4960.34**	**8.8**	**9.6**	**8.1**
1996	2898.81	1510.48	1388.33	13.0	14.5	11.7
1997	3251.62	1827.92	1423.70	14.8	17.8	12.1
1998	3239.49	1837.12	1402.37	14.7	17.9	11.9
1999	3606.30	1949.31	1656.99	16.5	19.0	14.2
2000	4743.08	2492.12	2250.97	22.0	24.6	19.7
Total of last 5 years	**17739.30**	**9616.95**	**8122.36**	**16.2**	**13.9**	**13.9**

Source: MOFTEC statistics and customs

Exports of large developing countries and Australia, 1978-1998 (US $ billion)

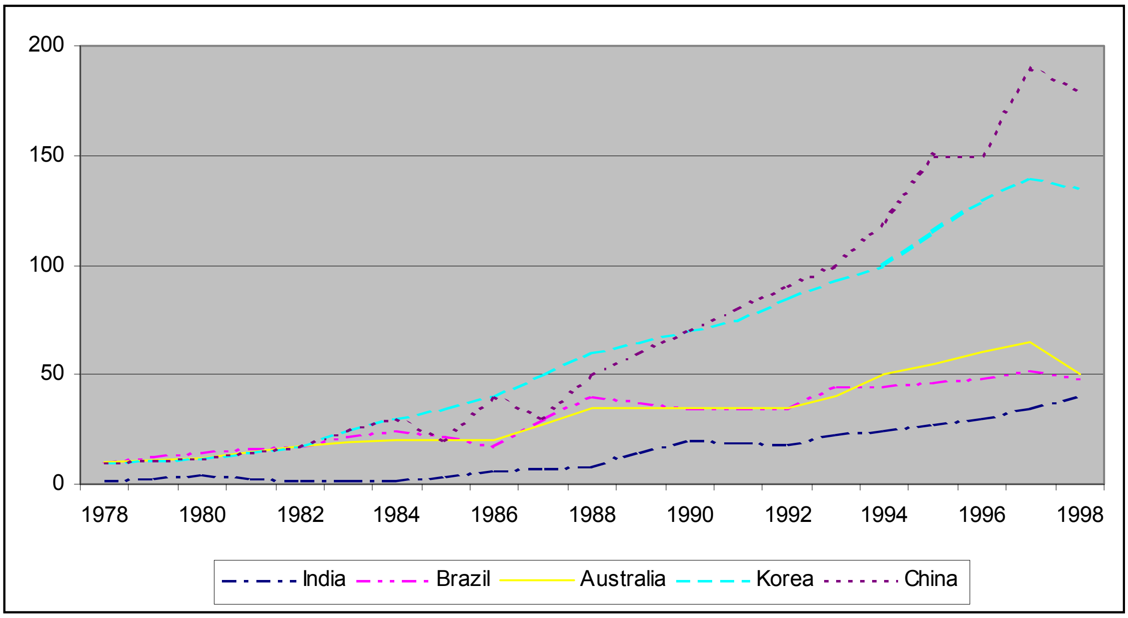


Figure 2

During the last 10 years, China's reform of its foreign trade and economic system was further deepened and the pace of opening Cup noticeably accelerated. China introduced the registration system, under which state-owned large and medium-sized manufacturing enterprises, commercial enterprises, scientific and research institutes were granted the trading rights after registering with competent authorities. State-owned trading enterprise were reorganized and restructured, which marked a new step toward the establishment of modern enterprise system. The import and export right of private production enterprises was also lifted, which is of historic significance.

Today, 32000 Chinese enterprises of various natures (excluding enterprises with foreign investment) enjoy import and export rights. See table 3.

1991-2000 Company Type Structure of Chinese Exports (billions of USD)

Table 3

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total	718.43	849.40	917.44	1210.06	1487.80	1510.48	1827.92	1838.09	1949.31	2492.12
State-owned enterprises				849.43	992.50	860.58	1027.41	968.53	984.86	1164.49
Foreign investment enterprises	120.47	173.60	252.37	347.09	468.91	615.06	749.40	809.00	886.28	1194.11
Collective enterprises				10.73	22.81	30.73	45.38	54.02	68.24	105.68
Others				2.81	3.58	4.11	5.73	6.07	9.94	27.53

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In addition, China continued to mark several substantial tariff cuts and brought the average tariff level down to the present 12%, i.e. 57 % lower than that at the end of the 1995. It is also indicated that it would fulfill its promise to cut the average tariff on imported capital goods to 10 per cent by 2005. China became a net importer of grain in 1993 and oil in 1994, meanwhile the quota and license system was also reformed. China further relaxed restriction on the areas open to foreign investment participation, resulting in the opening-up of commerce, banking, insurance, tourism and other service sectors to varying degrees.

Especially, during 1996-2000, China's foreign trade and economic sector further improved its quality level and efficiency. China's import and export mix was optimized with electromechanical and high-tech products taking up a respective 42.3 per cent and 14.8 per cent of the export total in 2000.

b) FDI

The total inflow of FDI amounted to 47 billion us $ in 2001. China has been the largest FDI receipt among developing countries since 1993. From 1996 to 2000, China cumulatively absorbed USD 213.48 billion of FDI (actually utilized amount), the average annual FDI inflow was above 40 billion and the industrial added value originated from foreign-invested enterprises took up 20.9 per cent of the national total. At present, there are nearly 180,000 foreign-investment enterprises in operation, directly providing almost 20 million jobs. See figure 3 and table 4.

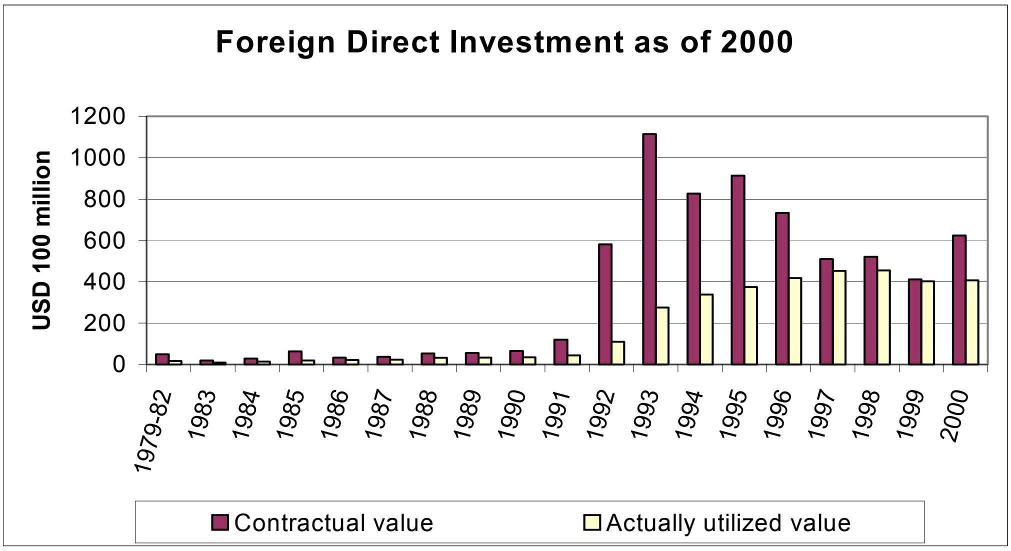

Figure 3

Foreign Direct Investment as of 2000 (USD 100 million)

Table 4

Year	No. of projects	Contractual value	Actually utilized value
1979-82	920	49.58	17.64
1983	638	19.17	9.16
1984	2,166	28.75	14.19
1985	3,073	63.33	19.56
1986	1,498	33.30	22.44
1987	2,233	37.09	23.14
1988	5,945	52.97	31.94
1989	5,779	56.00	33.93
1990	7,273	65.96	34.87
1991	12,978	119.77	43.66
1992	48,764	581.24	110.08
1993	83,437	1114.36	275.15
1994	47,549	826.80	337.67
1995	37,011	912.82	375.21
1996	24,556	732.76	417.26
1997	21,001	510.03	452.57
1998	19,799	521.02	454.63
1999	16,918	412.23	403.19
2000	22,347	623.80	407.15
Total	**363885**	**6760.98**	**3483.44**

Source: MOFTEC foreign investment statistics

Recent state policy

More recent state policy has been trying to shift the weight (around 90 per cent) of FDI away from the East coast (especially the South-East coast) areas and towards the relatively neglected interior provinces. China open-door policy first began at the South-east coast, four Special Economic Zones (SEZ) were set up in 1980, they were 'special' in the sense that concessions such as lower taxes and tariffs and more flexible employment policies were granted in order to attract foreign capital, technology and know-how. As the testing ground for developing a market-oriented, open economy, numerous reform measures have first been experimented in the SEZs and those useful ones are later introduced into the rest of the economy, e.g. employment is now based on labor contracts. Ownership structure is changing from a pure state ownership to a mixed one. FDI in the tertiary sector, such as retailing, insurance banking and other finance and information services are expanding. Stock, bond and futures markets are developing etc .No one doubts the great success of Special Economic Zones.

According to these successful experiments, the Great Western Development launched in January 2000, attempt to prevent the quarter of the country's population that lives in the far West from falling even farther behind people in the prosperous eastern coastal region. The land-locked west comprises more than half of China's land area, is home to 80 per cent of China's official minorities. Only 3 per cent of the 300 billion foreign investments in China since 1978 have gone to the West.

As of one January 2000, foreign-invested business in western and central provinces would enjoy a preferential 15 per cent rate of income tax for three years, especially for making high-density fertilizers, stainless steel and micro-electronics products (most domestic companies pay a 33 per cent income tax). If the foreign-invested firms move some production inland, the government gave the region the power to grant an additional eight years of tax breaks (in any size).

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