

Economic Development of Mainland China

INTRODUCTION TO CHINA ECONOMY

The People's Republic of China was founded in 1949. Its economic development over the past five decades can be divided into two periods: the post-reform and pre-reform periods.

China's economic growth in recent decades has been driven by several important factors such as the development of the rural non-farming sector, massive inflow of foreign capital, structural transformation, reform-induced efficiency improvement and promotion of trade.

● Economic Development Since Reform, and Prospects for the 21st Century

1. Three Types of Reforms: Agriculture Reform, Enterprises Reform, Market Reform.

The first step in China's reform is to introduce the household responsibility system (HRS) in rural areas. In urban areas, reform focused on decentralizing powers to state-owned enterprises (SOEs) and on allowing them to share profits. Non-collectively-owned enterprises were permitted.

Prices for products and production factors were gradually readjusted or partially liberalized.

The government also adopted an opened-door policy to attract foreign capital, allow foreign direct investment (FDI), establish joint ventures or exclusively foreign-owned enterprises. In 2002 China for the first time overtook the United States as the world's largest recipient of foreign capital. The major hosting regions (e.g., Guangdong, Shanghai, Jiangsu, Shandong and Fujian) in China tend to enjoy a high rate of growth.

Structural transformation: As an economy develops, the primary sector declines and the service sector expands in terms of both employment and income shares.

Promotion of trade: Trade not only generated China's much needed foreign exchange but also promoted technology transfer and brought about competition in the former centrally planned system. The China economy will become more liberalized and the Chinese

market more accessible in the near future.

The Chinese economy has been transformed from a typical centralized planned economy into one where the market plays a major role in resource allocation.

Table 1.1 shows that several significant economic indicators in China were twice or even three times as those of other countries and the world average.

[Show TABLE 1.1]

Following the implementation of reform, China's economic growth underwent a momentous change.

With rapid economic growth, the income of rural and urban households increased significantly.

These changes raised the living standards of the Chinese people and improved their quality of life considerably. The Engel's coefficient (the ratio of consumption expenditure on food to total expenditure of daily life) for urban and rural residents decreased respectively from 57.5% and 67.7% in 1978 to 39.2% and 49.1% in 2000.

The lower Engel's coefficient indicates that the life of the Chinese people is undergoing the change from the level of being sufficiently fed and clothed to a comfortable level, and that the living quality of China's urban and rural residents is going up steadily.

As for consumer durables, not only did the amount owned by households increase dramatically during the period 1978-2000, but the consumption structure also changed considerably.

2. Will The Sleeping Lion Actually Wake Up?

In 2000, China's GDP ranked the sixth largest economy in the world.

Since initiating its reform, China has devalued its currency several times.

China's actual economic scale far exceeds the estimate based on the official exchange rate.

[Show TABLE 1.4]

As indicated in Table 1.5, in 1991, based on the official foreign exchange rate, the size of China's economy ranked tenth in the world. However, it ranked third when GDP was estimated using PPP

calculations.

[Show TABLE 1.5]

Many scholars predict that if China can overcome internal and external constraints and can maintain this trend for the next 20 to 30 years, it will become the largest economy in the world.

3. Question: What factors will determine a country's economic growth?

Generally speaking, a country's economic growth rate is determined by three factors: (1) the increase of various production factors, especially capital; (2) the upgrading of industrial structure from low-value-added industry to high-value-added industry; and (3) the technological innovation. Among these factors, technological innovation is the most important.

To begin with, the fact that Chinese economy can maintain a high growth rate can be attributed to its high capital accumulation rate.

The second factor is the upgrading of the industrial structure, especially the shift of labor forces to higher-value-added industries, which can provide strong support for economic growth.

The third factor is China's so-called "advantage of backwardness" in technology. There are two ways to realize technological innovation: (1) through conducting independent research and development (R&D) by self-investment, and (2) through learning from, imitating, or purchasing advanced technologies from other countries.

If relying on that technological gap to obtain low-cost technological innovation could help Japan and the four Little Dragons maintain a high economic growth rate for 40 years, it seemed logical that it would help China do the same.

The potential for resource reallocation from low-value-added sectors to higher-value-added ones was greater in China. Meanwhile, China's capital accumulation rate is about 40% of the GDP, which is among the highest in the world.

Two more factors contribute to China's potential for achieving rapid economic growth. First, the country's potential for improving institutional efficiency is still considerable.

In the early stage of reform, China improved its resource-allocation mechanism in the agricultural sector by giving up the collective farming and adopting the household responsibility system (HRS).

We believe that further reform of SOEs with an emphasis on the creation of markets for fair competition will greatly improve the production efficiency in China.

Second, China's size is an important factor in maintaining rapid economic growth.

However, there is still a wide gap between the coastal areas of China and developed countries.

The growth potential in the central and western regions is even more impressive than the growth potential of the eastern regions.

Considering China's large population, not only will the absolute number of skilled labourers in the country be large, but also the number of gifted scientists.

China's size may thus become an important factor in its reassertion of economic leadership in the world after losing its position in the wake of industrial revolution.

In short, if China can maintain a long-term rapid economic growth rate, it will become the largest economy in the world in the first half of the 21st century.

● **POLICY BARRIER TO PERSISTENT GROWTH**

Delays in structural transition or mistakes in development strategy could slow the growth process or even derail it altogether.

1. Cyclical Fluctuations in the Economy

There have been four cycles over the past 22 years, each lasting an average of 4 to 5 years.

Unfortunately, the degree of these fluctuations displayed an increasing trend, which not only interfered with the goal of achieving a stable and high growth rate but also gave rise to the fear that China's economy might crash during the fluctuations.

2. An Increase in Serious Corruption

The difference between planned prices and market prices is known as the institution rent. Using unscrupulous means to gain from the

institution rent is called rent-seeking.

As long as there is institutional rent, enterprise will not cease rent-seeking.

3. Problems in the Banking System

It is estimated that the proportion of non-performing and bad loans in China's commercial banks is about 25% or more.

If the proportion of non-performing and bad loans continues to rise, depositors will eventually lose confidence in the banking system. In addition, the risk of the banking system being attacked by foreign speculators will increase as the openness of the financial market increases after the WTO accession.

4. Serious Losses of State-owned Enterprises

Before the reform, government revenue came mainly from the taxes and profits of SOEs. Since the reform, SOEs have performed poorly. If a large number of SOEs go bankrupt simultaneously, many workers will be laid off.

5. Widening of the Interregional Disparities

At the initial stages of reform, the gaps among China's eastern, central, and western regions and the gap between rural and urban areas were narrowing. However, after 1985, the gaps widened again. It is difficult for the central government to make and implement policies that satisfy everyone.

The number of rural migrants in Chinese cities is now estimated at between 80 and 100 million.

6. Problems of Grain Production

To ensure that the people were fed is the reason the government tolerated the implementation of the household contract system in the late 1970s.

Where China can produce enough grain and whether it can regulate production fluctuations through international markets without imposing too much of an adverse effect on other regions in the world will become important questions.

7. Deflation after 1998

From the beginning of 1998 to the present day, the Chinese economy has encountered a deflation. The monthly wholesale price index of production materials, compared to the index in the same period of the previous year, has been falling.

Once a deflation occurs in an economy, it is often very difficult for the economy to regain dynamic growth.

Therefore, if the current deflation cannot be eliminated soon, China may not be able to complete the transition to a market economy smoothly.

8. Challenges of WTO Accession

The basic spirit of the WTO is to lower tariff rates, to eliminate non-tariff barriers, and to allow market entries so that production could be allocated globally according to the principle of comparative advantage.

However, China's transition to a market economy has not complete.

It is also possible that the market competition after the WTO accession may do more harm than good to the Chinese economy.

The exacerbation of any one of the problems may lead to the collapse of the national economy.

● KEY QUESTIONS

Why was China able to catch up so fast and to achieve such tremendous economic progress in just two decades or so? Will China be able to maintain its rapid growth? These are questions that everyone—Chinese and otherwise—would like answered.

The nature of its experiences in development and reform and the question of whether the experiences have general implications are of great interest to other economics undergoing similar types of development and transition.

Why China's economy was developing so slowly before the reform was implemented but has been developing so rapidly afterwards.

In the 30 years prior to the late 1970s, the goal of economic advantage was not achieved.

The second question is why China's reform has been slow in some areas and why the problems mentioned in the last section have recurred

throughout the reform process.

Bottlenecks, including inflation pressures, corruption, and the recurring vigour/chaos cycle.

The third question is whether the momentum of China's reform and development can be sustained.

China still faces many barriers to reform and development. If these obstacles cannot be overcome, the current momentum of reform and development will not be sustainable.

The fourth question is why China's reform has been so successful, compared with the reforms of the former Soviet Union and Eastern European countries.

During the reform process, China has moved closer and closer to a market economy. It has controlled the pressure of inflation, relaxed growth-constraining bottlenecks, and eliminated political disturbances to realize persistent and rapid economic growth.

The most likely explanation for the dramatic dissimilarity in the reform results lies in the differences in reform approaches.

APPENDIX

● The PPP method

The PPP method considers a bundle of goods, then calculates the price of this bundle in each country (using the country's local currency.) To calculate the exchange rate between two currencies, one takes the ratio of the prices.

A simple example of a measure of absolute PPP is the Big Mac index popularised by The Economist, which looks at the prices of a Big Mac burger in McDonald's restaurants in different countries. If a Big Mac costs USD\$4 in the US and GBP£3 in Britain, the PPP exchange rate would be £3 for \$4. In the same way, if a Big Mac or any basket of goods costs USD\$4 in the US, the PPP exchange rate is always GBP£3 for \$4.

● Principle of Comparative Advantage

When one entity (be it a firm or a country) is able to produce more efficiently than another entity it has an **absolute advantage**; that is, assuming equal inputs, the entity with an absolute advantage will have a greater output.

However, the *relative costs* of producing those two goods are different in the two countries. If one country has a *relative costs* of producing X, this country has a comparative advantage in producing X.

Example: Suppose there are two countries, Northland and Southland. Both have a wine-making industry and a clothing industry.

Production capabilities per day

Country	Clothes	wine
Southland	1	1
Northland	0.33	0.2

Southland has an "absolute advantage" in both industries – it is more

productive at making both **wine** and clothes. However, it is 5 times more productive than Northland in wine making and only 3 times more productive than Northland in Clothes making. That is, it has a *comparative advantage* in wine making. While Northland is worse at making either kind of goods, it is least deficient at making clothes.

● Economic Systems

1. Market Economy

In a *market economy*, consumers and businesses decide what they want to produce and purchase in the marketplace. They make these decisions by “voting with their dollars.” Producers decide what to produce given the demand they see in the marketplace in terms of their sales and the prices they get for their goods and services. In a pure market economy, also known as a *laissez-faire* economy (from the French “allow to do”), the government plays a very limited role in what is produced. The government does not direct, and may even lack the power to direct, the private sector to produce certain goods and services.

2. Command Economies

In command economies, the people (in the form of the state) own the means of production. The state, which is seen to embody the will of the people, decides what will be produced according to a plan based upon what the state calculates to be people's need and desire for various goods and services. The state also plays an important role in determining how goods and services are distributed, that is, in deciding who gets how much of what.

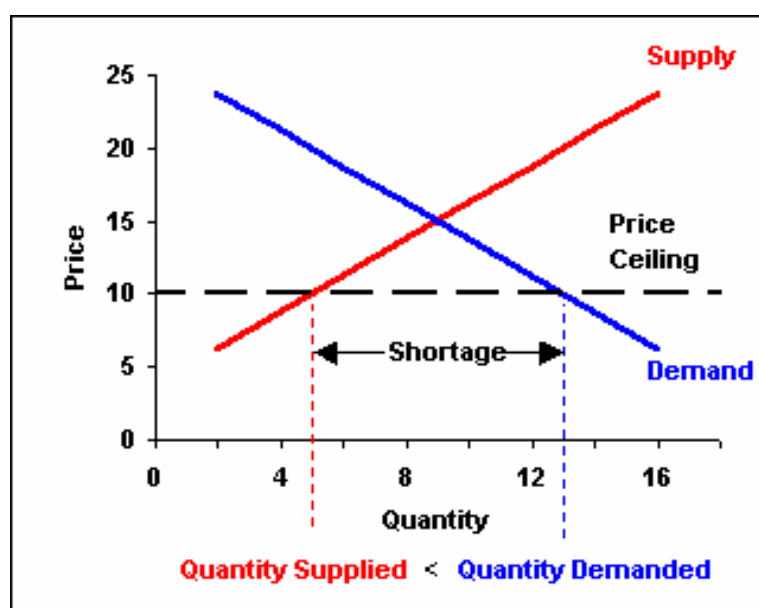
Disequilibrium:

Price Ceiling

A price ceiling sets the *maximum* price that can be charged in a market. With an effective price ceiling the market price is forced to remain below the equilibrium price level. The "ceiling" prevents the market price from rising to the equilibrium level. The economic consequences are several:

1. Market price below the equilibrium level.
2. The quantity demanded is greater than the quantity supplied.
3. Market shortages will occur.
4. Deterioration of product quality.
5. Black markets.

A common example of a price ceiling is rent control. A black market will appear where rent controlled housing is subleased at higher prices to those willing and able to pay.

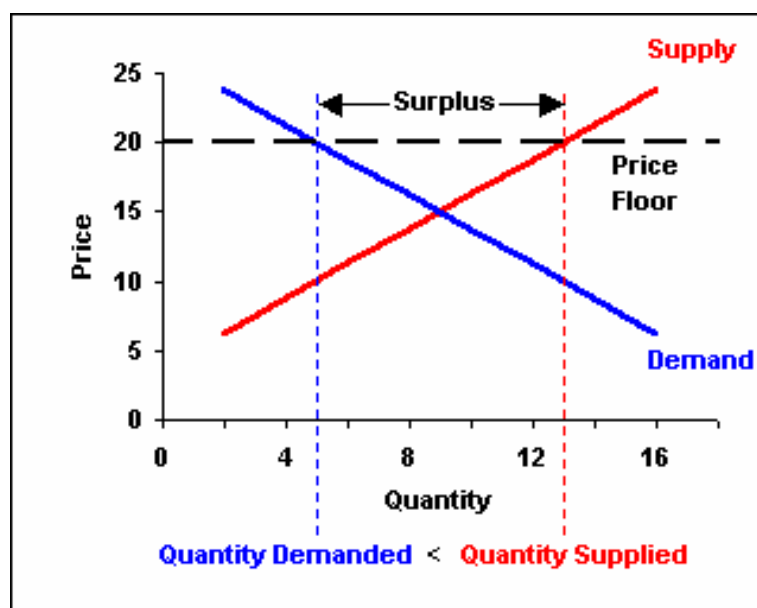


Price Floor:

A price floor is the opposite situation of a price ceiling. A price floor sets the *minimum* price that can be charged in a market. With an effective price floor the market price is forced to remain above the equilibrium price level. The "floor" prevents the market price from falling to the equilibrium level. The economic consequences of a price floor are:

1. Market price above the equilibrium level.
2. The quantity supplied is greater than the quantity demanded.
3. Surpluses will occur.
4. Suppliers compete for customers by improving product quality.

A common example of a price floor is the minimum wage (first established in 1938 at 25 cents per hour). The minimum wage sets a minimum dollar amount that a firm can pay its employees.



3. Mixed Economy

In a *mixed economy* both market forces and government decisions determine which goods and services are produced and how they are distributed. In general, market forces prevail in mixed economies. The government does not direct the private sector to produce certain goods and services in certain quantities at certain times. However, the government's influence in the economy stems from the amount of money (raised in the form of taxes and borrowings from the private sector) that it spends and, through various forms of *welfare*, redistributes.

Today, the economies of most industrial countries are considered mixed economies. In Western European nations the government usually plays a larger role in the economy than in North America. Since the fall of the Soviet Union in 1991, the only two major planned economies are those of North Korea and the People's Republic of China. However, China has begun to incorporate some market mechanisms, such as competition, into its economy.

● **Exchange Market Systems**

An exchange rate is the rate at which one currency can be exchanged for another. In other words, it is the value of another country's currency compared to that of your own. If you are traveling to another country, you need to "buy" the local currency. Just like the price of any asset, the exchange rate is the price at which you can buy that currency. If you are traveling to Egypt, for example, and the exchange rate for USD 1.00 is EGP 5.50, this means that for every U.S. dollar, you can buy five and a half Egyptian pounds. Theoretically, identical assets should sell at the same price in different countries, because the exchange rate must maintain the inherent value of one currency against the other.

1. Fixed Rate

There are two ways the price of a currency can be determined against another. A fixed, or pegged, rate is a rate the government (central bank) sets and maintains as the official exchange rate. A set price will be determined against a major world currency (usually the U.S. dollar, but also other major currencies such as the euro, the yen, or a basket of currencies). In order to maintain the local exchange rate, the central bank buys and sells its own currency on the foreign exchange market in return for the currency to which it is pegged.

2. Floating Rate

Unlike the fixed rate, a floating exchange rate is determined by the private market through supply and demand. A floating rate is often termed "self-correcting", as any differences in supply and demand will automatically be corrected in the market. Take a look at this simplified model: if demand for a currency is low, its value will decrease, thus making imported goods more expensive and thus stimulating demand for local goods and services. This in turn will generate more jobs, and hence an auto-correction would occur in the market. A floating exchange rate is constantly changing.

In reality, no currency is wholly fixed or floating. In a fixed regime, market pressures can also influence changes in the exchange rate. Sometimes, when a local currency does reflect its true value against

its pegged currency, a "black market" which is more reflective of actual supply and demand may develop. A central bank will often then be forced to revalue or devalue the official rate so that the rate is in line with the unofficial one, thereby halting the activity of the black market.

Table 1: China's Economic Indicators (1)

Year	國內生產總值	人均國內生產總值	國內生產總值指數	人均國內生產總值指數
	Gross Domestic Product (100 million RMB)	per capita GDP (RMB)	Gross Domestic Product Index (previous year=100)	per-capital GDP index (previous year=100)
1978	3624.1	379	111.7	110.2
1979	4038.2	417	107.6	106.1
1980	4517.8	460	107.8	106.5
1981	4860.3	489	105.2	103.9
1982	5301.8	525	109.3	107.5
1983	5957.4	580	111.1	109.3
1984	7206.7	692	115.3	113.7
1985	8989.1	853	113.2	111.9
1986	10201.4	956	108.5	107.2
1987	11954.5	1106	111.5	109.8
1988	14922.3	1355	111.3	109.5
1989	16917.8	1512	104.2	102.5
1990	18598.4	1634	104.2	102.3
1991	21662.5	1879	109.1	107.7
1992	26651.9	2287	114.1	112.8
1993	34560.5	2939	113.1	112.2
1994	46670	3923	112.6	111.4
1995	57494.9	4854	109	109.3
1996	66850.5	5576	109.8	108.4
1997	73142.7	6053	108.5	107.7
1998	78017.8	6392	107.8	106.7
1999	82067.5	6551	107.2	106.2
2000	89468.1	7086	108.4	107.1
2001	97314.8	7651	107.2	106.7
2002	104790.6	8184	108.5	107.2

Table 2: China's Economic Indicators (2)

Year	城鎮居民 家庭平均每人 全年可支配 收入絕對數 Per Capita Annual Disposable Income of Urban Households (RMB)	城鎮居民家庭 平均每人全年 可支配收入指數 Index of Per Capita Annual Disposable Income of Urban Households (1978=100)	農村居民家 庭平均每人全 年純收入絕對數 Per Capita Annual Net Income of Rural Households (RMB)	農村居民家庭 平均每人全年 純收入指數 Index of Per Capita Annual Net Income of Rural Households (1978=100)
1978	343.4	100	133.6	100
1979			160.7	
1980	477.6	127	191.3	139
1981			223.4	167.3
1982			270.1	202.2
1983			309.8	231.9
1984			355.3	266
1985	739.1	160.4	397.6	268.9
1986	899.6	182.5	423.8	277.6
1987	1002.2	186.9	462.6	292
1988	1181.4	182.5	544.9	310.7
1989	1375.7	182.8	601.5	305.7
1990	1510.2	198.1	686.3	311.2
1991	170.6	212.4	708.6	317.4
1992	2026.6	232.9	784	336.2
1993	2577.4	255.1	921.6	346.9
1994	3496.2	276.8	1221	364.4
1995	4283	290.3	1577.7	383.7
1996	4838.9	301.6	1926.1	418.2
1997	5160.3	311.9	2090.1	437.4
1998	5425.1	329.9	2162	456.8
1999	5854	360.6	2210.3	473.5
2000	6280	383.7	2253.4	483.5
2001	6860	416.3	2366	503.8
2002	7703	427.1	2476	528

Table 3: China's Economic Indicators (3)

Year	全社會固定 資產投資總 額 Total Investment in Fixed Assets (100 million RMB)	商品零售物 價指數 Retail Price Index (previous year=100)	居民消費 價格指數 Consumer Price Index (previous year=100)	實際利 用外資額 Foreign Capital Actually Utilized (US\$10 thousand)
1978		100.7	100.7	
1979		102	101.9	
1980	910.9	106	107.5	
1981	961	102.4	102.5	
1982	1230.4	101.9	102	
1983	1430.1	101.5	102	198100
1984	1832.9	102.8	102.7	270500
1985	2543.2	108.8	109.3	464700
1986	3120.6	106	106.5	725800
1987	3791.7	107.3	107.3	845200
1988	4753.8	118.5	118.8	1022600
1989	4410.4	117.8	118	1005900
1990	4517	102.1	103.1	1028900
1991	5594.5	102.9	103.4	1155400
1992	8080.1	105.4	106.4	1920200
1993	13072.3	113.2	114.7	3896000
1994	17042.1	121.7	124.1	4321300
1995	20019.3	114.8	117.1	4813300
1996	22913.5	106.1	108.3	5480400
1997	24941.1	100.8	102.8	6440800
1998	28406.2	97.4	99.2	5855700
1999	29854.71	97	98.6	5265900
2000	32917.73	98.5	100.4	5935600
2001	37213.49	99.2	100.7	4967200
2002	43499.91	98.7	99.2	5501100

Table 4: China's Economic Indicators (4)

	國家銀行各項存款合計	國家銀行各項貸款合計	全社會固定資產投資總額	商品零售物價指數
	Total Deposits (100 million RMB)	Total Loans (100 million RMB)	Total Investment in Fixed Assets (100 million RMB)	Retail Price Index (previous year=100)
1978	1134.5	1850		100.7
1979	1339.1	2039.6		102
1980	1661.2	2414.3	910.9	106
1981	2027.4	2860.2	961	102.4
1982	2369.9	3180.6	1230.4	101.9
1983	2788.6	3589.9	1430.1	101.5
1984	3583.9	4766.1	1832.9	102.8
1985	4264.9	5905.6	2543.2	108.8
1986	5354.7	7590.8	3120.6	106
1987	6517	9032.5	3791.7	107.3
1988	7425.8	10551.3	4753.8	118.5
1989	10786.2	14360.1	4410.4	117.8
1990	14012.6	17680.7	4517	102.1
1991	18079	21337.8	5594.5	102.9
1992	23468	26322.9	8080.1	105.4
1993	29627	32943.1	13072.3	113.2
1994	40502.5	39976	17042.1	121.7
1995	53882.1	50544.1	20019.3	114.8
1996	68595.6	61156.6	22913.5	106.1
1997	82390.3	74914.1	24941.1	100.8
1998	95697.9	86524.1	28406.2	97.4
1999	108778.9	93734.3	29854.71	97
2000	123804.4	99371.1	32917.73	98.5
2001	143617.2	112314.7	37213.49	99.2
2002	170917.4	131293.9	43499.91	98.7

Table 46: Taiwan and Mainland China Individual Deposits

期 間 Period	臺灣 Taiwan			中國大陸 Mainland China		
	期末餘額 Amount end of period	人口數 Population	平均每人存 款 Average deposit per person	期末餘額 Amount end of period	人口數 Population	平均每人存 款 Average deposit per person
	(US\$100 million)	(10,000 persons)	(US\$)	(US\$100 million)	(10,000 persons)	(US\$)
1991	2,619.25	2,061	12,711.09	1,712.50	115,823	147.85
1992	3,333.11	2,080	16,022.25	2,095.40	117,171	178.83
1993	3,645.89	2,100	17,365.51	2,634.90	118,517	222.32
1994	4,234.34	2,118	19,994.04	2,546.60	119,850	212.48
1995	4,466.81	2,136	20,914.98	3,565.20	121,121	294.35
1996	4,862.02	2,153	22,587.80	4,641.60	122,389	379.25
1997	4,399.48	2,174	20,234.00	5,589.60	123,626	452.14
1998	4,638.06	2,193	21,150.35	6,450.12	124,761	517.00
1999	5,366.52	2,209	24,293.90	7,200.72	125,786	572.46
2000	5,459.90	2,228	24,509.13	7,668.12	126,743	605.01
2001	5,385.61	2,241	24,033.41	8,908.50	127,627	698.01
2002	5,552.47	2,252	24,654.88	10,496.46	128,453	817.14
2003	5,998.94	2,260	26,538.64	12,514.21	129,227	968.39
2004	6,832.16	2,269	30,112.04	14,439.06	129,988	1,110.80
2005	7,087.82	2,277	31,127.38	17,478.00	130,756	1,336.69
2006						
Jan.	7,292.76	2,278	32,015.88	18,359.75	130,756	1,404.12
Feb.	7,241.04	2,278	31,780.25	18,799.93	130,756	1,437.79
Mar.	7,234.53	2,279	31,742.87	19,061.87	130,756	1,457.82

Source: <http://www.chinabiz.org.tw/chang/Eco/160-2006-02/160-46.xls>

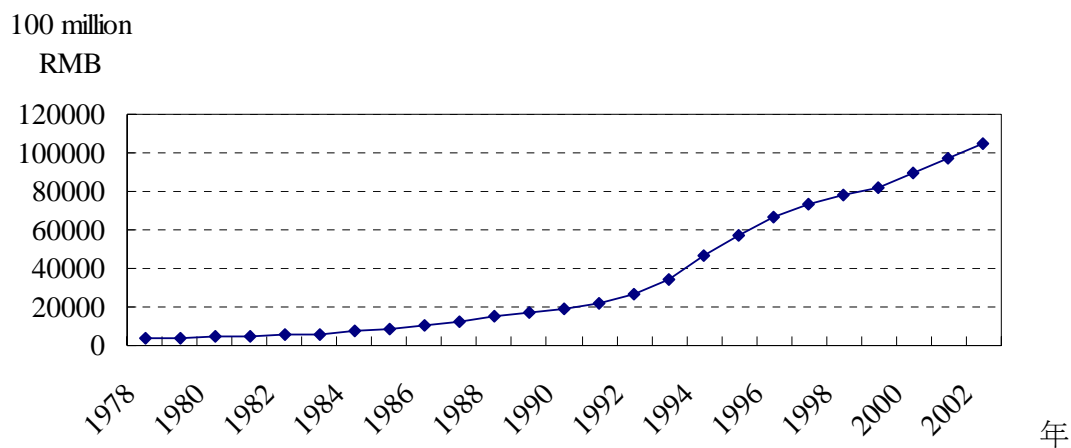


圖1：1978-2002Gross Domestic Product(GDP)

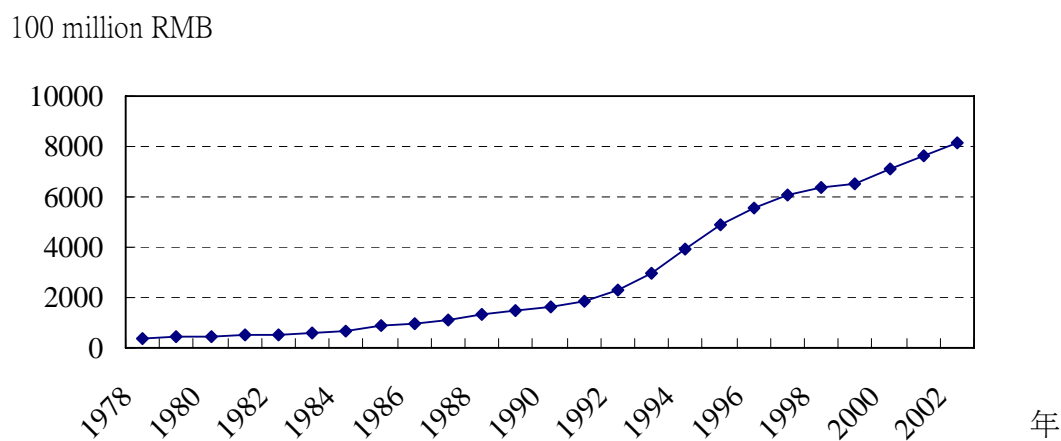


圖2：1978-2002 per capita GDP

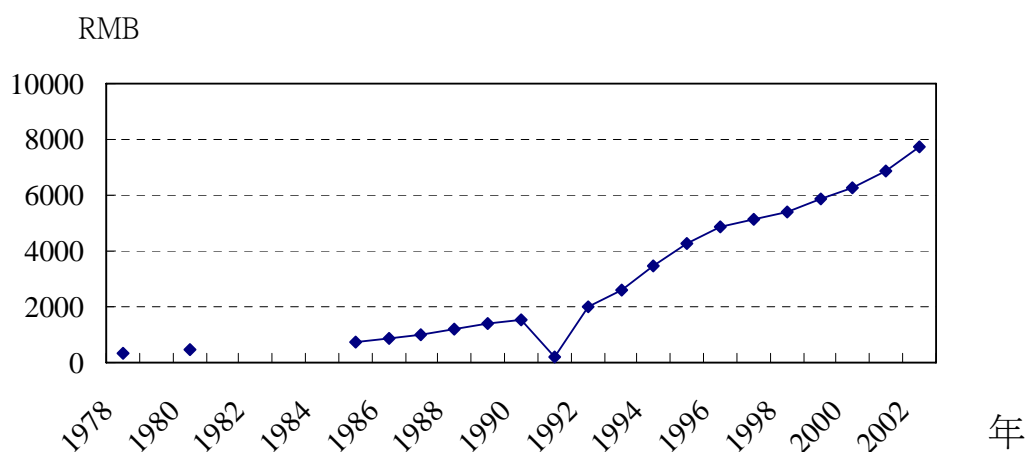


圖3：1978-2002 per Capita Annual Disposable Income of Urban Households

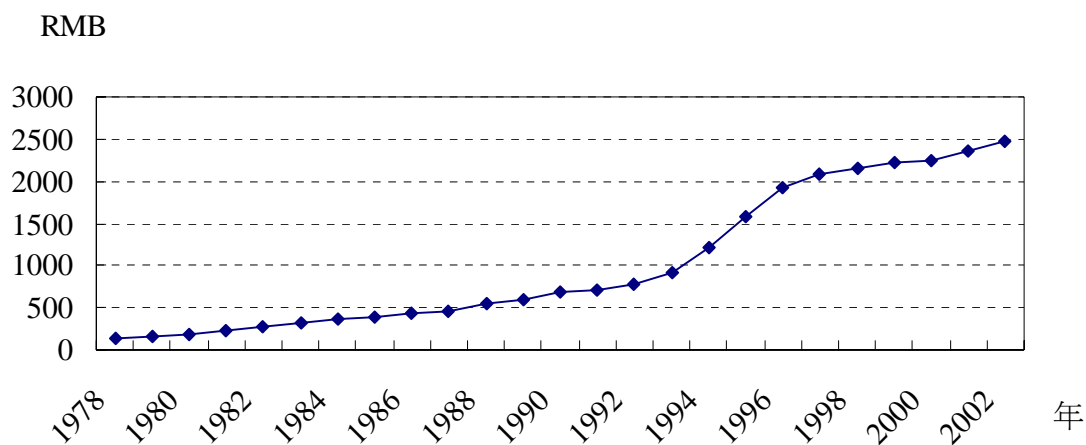


圖4：1978-2002 per Capita Annual Net Income of Rural Households

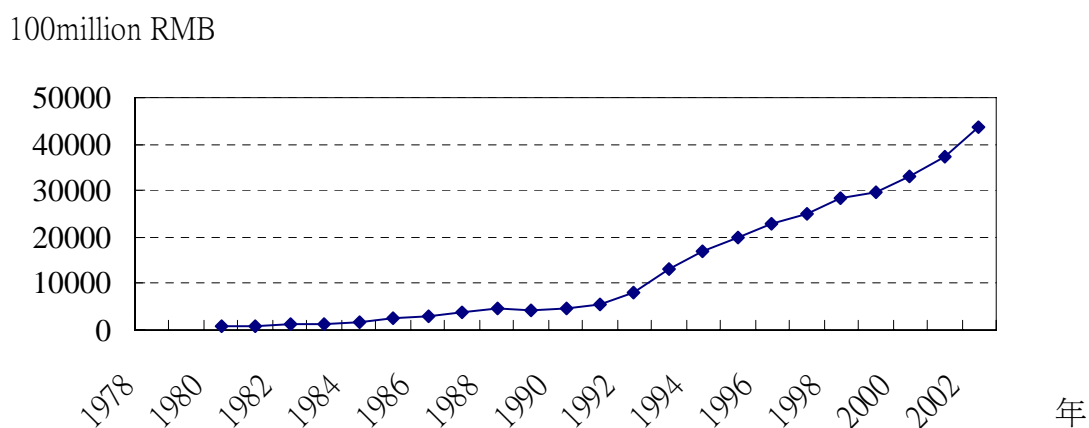


圖5：1978-2002 Total Investment in Fixed Assets

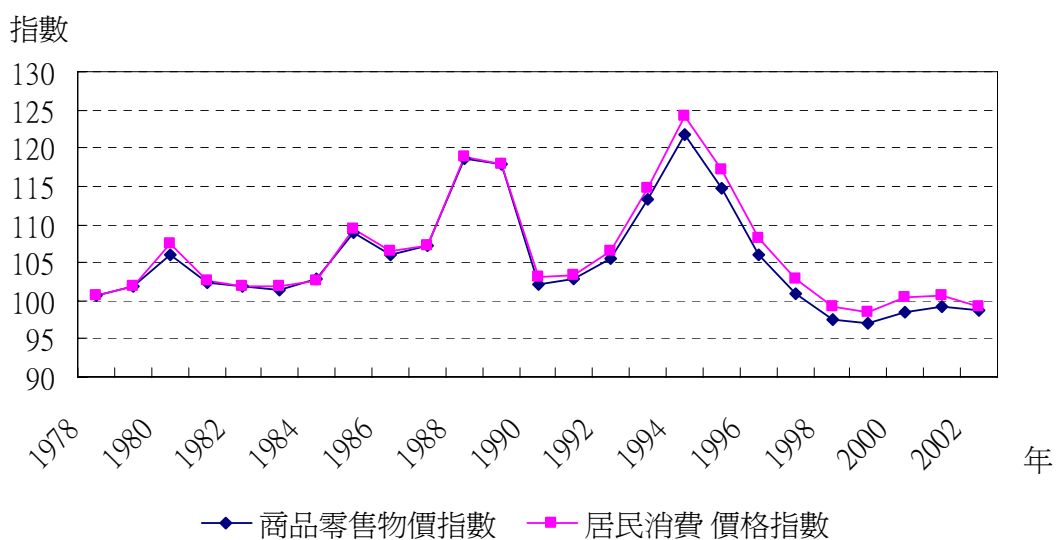


圖6：1978-2002 Retail Price Index & Consumer Price Index

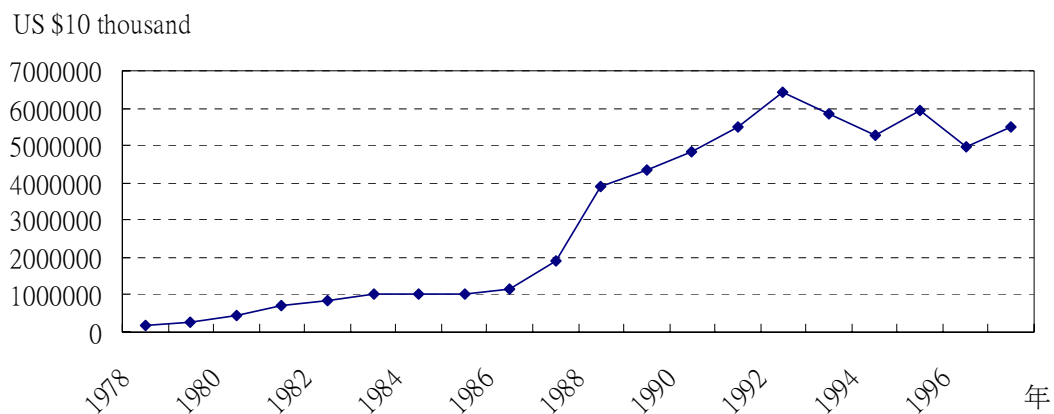


圖7：1978-2002 Foreign Capital Actually Utilized

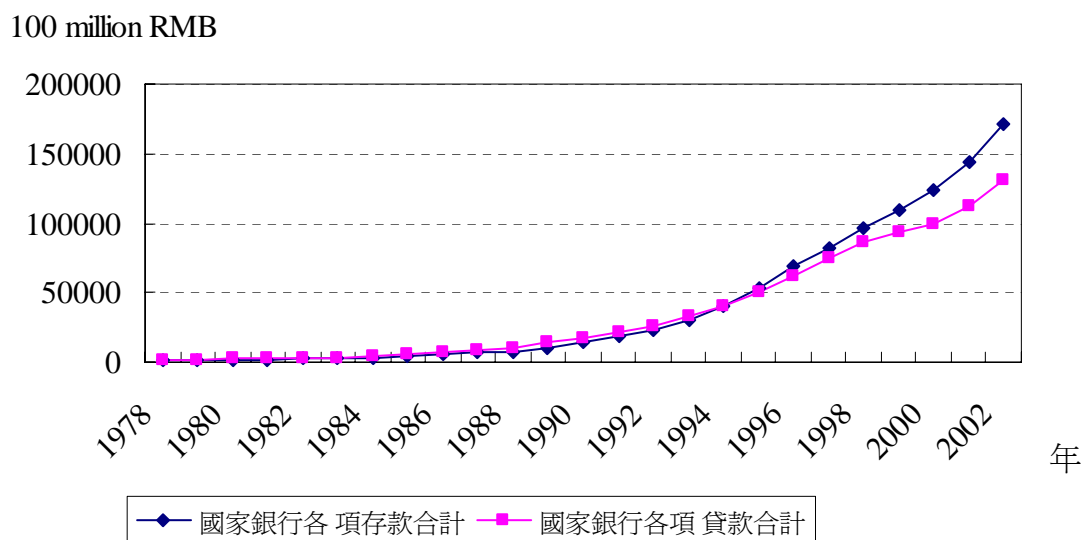


圖8：1978-2002 Total Deposits & Total Loans