

Evolution of China's Reform and Development*

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With its start marked by the 3rd Plenary Session of the 11th Central Committee of the Communist Party of China held in December 1978, China's reform has evolved throughout the past three decades. Over these 30 years, China's reform has garnered significant accomplishments on three fronts: 1) fast and constant economic growth. From 1978 to 2007, China's GDP grew at an annual rate of up to 9.8% on average. 2) a transition from a centralized, planned economy machinery to a market-oriented economy machinery. Great changes have taken place in terms of the ownership mix and the modes of resources allocation; 3) social stability and overwhelming improvement of the Chinese people's living standards by and large. China of the day has evolved into a medium income country from a low income one, and her social structure has also undergone changes.

It is no easy task for China to grow her economy fast and constantly and maintain social stability, in addition to effecting a series of reforms into her economic and social systems. As early as in 1980s, economists in East European countries ever likened the above task to replacing tyres or even the engine from time to time while driving a car on fast-turning wheels, which almost seems like a mission impossible. However, China has accomplished such a task, as a matter of fact.

Then what is her secret? In summary, China's success is mainly accredited to her efforts in properly handling the relations among reform, development and stability and in finding out a path of reform and development that suits her own conditions well. On the three fronts of the reform into the ownership mix, reform into the pricing mechanism and construction of a market based system as well as macro-economic management, China has not only cast away the stealthy practices in the course of East Europe's initial reform, but also refused to adopt such subsequent reformative measures of East Europe, which were based on the "The Washington Consensus" as fast privatization, price liberalization and macroeconomic retrenchment, and succeeded in solving these problems in her own creative way.

I. The Stage of Incremental Reform and Sprouting of Market-oriented Economy (1978~1992)

At the start of economic remodeling in the former Soviet Union and certain East European countries, many policies and suggestions stemmed from the so-called "The Washington Consensus" and laid a particular stress on the following few fronts: price liberalization, retrenchment-towards policies and balanced budgeting, which were intended to stabilize the then macro-economy, privatize state-owned enterprises and introduce acts of profit maximization (Gerard Roland, 2002: 6). In contrast, when China initialized her reform in 1978, the then Chinese government had no blueprint on hand, and was not clearly aware of either the objectives or pattern of its reform. However, at the time when the reform was launched, principles in the following five respects were already made clear: (1) the reform aimed to "develop social productivity and constantly meet the people's growing demands in material and cultural terms"; (2) the yardstick for evaluation of the reform was whether the national economy grew and the people were enabled to embrace more benefits. To be specific, the evaluation was conducted to see "whether sophisticated managerial measures were adopted, how the technological renovation was carried out, to what extent the labor productivity was enhanced, how much the profitability was increased, and to what degree the individual benefits of laborers and those of the collective were augmented"¹; (3) the reformative measures were to "start in certain parts" "allow and encourage experiments"², so as to conduct experiments and sum up experience from time to time and "cross the

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1 See the speech made by Deng Xiaoping on the Closing Session of the Working Conference of the Central Committee of the Communist Party of China on 13 December 1978 (Deng Xiaoping, 1994: 150).

2 The same as above.

river by feeling for stones under the feet”³; (4) the basic principle of the reform was to “give full play to the initiatives of the state government, local governments, enterprises and laborers themselves”, and enable all parties to “emancipate their zeal to innovate by all means”⁴; (5) the political premise on the reform was “not to do any harm on the country’s fundamental political system and not to jeopardize the social stability”⁵.

The very first scheme of reform was to adjust the planned economy machinery under which state-owned enterprises played a lead role, with an emphasis laid on the law of value⁶ and separation of powers as to enterprises. Such scheme is, in actuality, still an improved kind of economy planning plan. As early as in 1979, China has drafted out a “general scheme of the reform”, and put forward such reformative measures as indirect planning, and augmentation of the decision-making powers held by state-owned enterprises and collectively owned ones, etc. (the then National Commission for Economic Restructuring, 1988: 18). This scheme was palpably influenced by the early-stage reform in East Europe, but allowed non-public economy to grow in certain peripheral regions and to set prices at liberty. Hence, market-oriented economy took the lead to develop in certain rural areas where the then planned economy system was influencing weakly.

1. Rural reform

Before the reform, Chinese rural areas were governed by the people’s commune system, under which lands were owned by the collective, peasants labored collectively, incomes were distributed evenly, and agricultural products were purchased and sold by the state government in a uniform way. Since 1958 when this system was established, certain peasants and local officials with courage for innovation in some areas have made ceaseless attempts at the possibility of household-based production, which won support from the then Chinese leaders such as Deng Xiaoping and Chen Yun. However, three major attempts, each on a relatively large scale, were deterred by powerful forces claiming adherence to collectivism.

In 1978, the policy of the then Chinese government on rural areas still featured the stabilization and improvement of the collective economy system for rural areas prevailing at that time, and disallowed household-based production. Meanwhile, the purchasing prices of agricultural products were increased by leaps (up to 20% in terms of the purchasing prices of cereal crops), and cereal crops were subject to quota purchasing, whilst those cereal crops sold by peasants beyond the quota were purchased at prices being 50% higher. However, as certain parts of the country were inflicted by natural disasters, cereal crops were unsatisfactorily harvested. Since 1978, Anhui and other provinces saw their leaders voice support for distributing land parcels to households so as to mobilize peasant households to conduct production and operations individually. In spite of the then fierce disputes aroused over such arrangement, the then central government did not take any measures to refrain from implementing such arrangement. By 1981, the situation has come quite clear that each and every area where the peasant household-based responsibility system was put into force recorded a huge increase in the output of cereal crops, and also saw their hosted peasants’ incomes increase swiftly. Measured by the yardstick of “development of productivity”, such reform is successful without doubt. Therefore, since 1982, such arrangement has been put into force across the entire country (Lu Mai, 1998: 15). From 1982 to 1984, the total output of cereal crops grew at an average annual rate of 7.8%. In 1984, the output of cereal crops amounted to 407.32 million tons, hitting a new record; and the per capita net income of peasants climbed to RMB 355 yuan in 1984 from RMB 133.6 yuan in 1978, recording an average annual growth rate of 16.5%. The income gap between urban areas and rural areas was lessened, and the per capita disposable income of urban residents was only 1.83 times that

3 In the Working Conference of the Central Committee of the Communist Party of China in December 1980, Chen Yun delivered an important speech and pointed out, “we must reform, but in steady paces --- sum up our experience from time to time, which means we shall cross the river by feeling about stones under feet’----”. (Chen Yun, 1995: 279)

4 See the speech made by Deng Xiaoping on the Closing Session of the Working Conference of the Central Committee of the Communist Party of China on 13 December 1978 (Deng Xiaoping, 1994).

5 See the speech made by Deng Xiaoping and titled “Adherence to Four Basic Principles” on 30 March 1979 (Deng Xiaoping, 1994).

6 The so-called law of value means that various products are subject to exchange at equal values according to their respectively required social necessary labor, encourages everyone to reduce labor consumption, and ensures the supply-demand balance for each kind of products by means of price adjustment (Sun Zhifang, 1979; Xue Muqiao, 1983). This is a theoretical abstraction based on market economy. In practice, decisions are still made by the state in view of the market supplies.

of rural residents.

The successful rural reform bears a typical trait of “incremental reform”. (1) with regard to the ownership system, lands, being the basic means of production in rural areas, still fall into the possession of the collective, while rural households are entitled to use and make revenues from lands. Although disputes over land ownership issues never came to a halt during the past 30 years which saw China effecting her reform, and some people have always been claiming privatization or nationalization of collectively owned lands (besides, such collective ownership system has indeed brought forth problems, including endless re-distribution of lands and easy transformation of agricultural lands into non-agricultural ones), there was no evidence showing that such institutional arrangement affected the efficiency of farm lands and the agricultural output. Therefore, it is untenable to simply equate the ownership system arrangement to fast privatization and to consider privatization as the premise on the operations of market-oriented economy. (2) as regards the pricing reform, such major agricultural products as cereal crops and cotton are purchased by the state government subject to quotas. The price differences arising within the scope of such quotas and agricultural tax as well as charges levied by village-level collective agencies are similar to a sort of quota tax, and jointly constitute the obligations of peasants to the state and the collective. Those incremental outputs beyond quotas may be sold by peasants to the state government at prices being 50% higher than the uniform purchasing prices set down by the state government, or sold at the market freely. In addition, the extra proceeds thus earned belong in full to producers themselves. Peasants comment on such institutional arrangement briefly as “to give enough to the state, retain enough for the collective, and all the rest stays with us”.

Hence, there came into shape a “dual system” as to the prices of cereal crops. Those cereal crops under the planned system were still purchased at low prices, so as to guarantee the supply of foodstuffs and lower wages to workers in urban areas, and to ensure the operations of the entire economic system. As to the sale of extra outputs at higher prices, buyers could be national departments in charge of cereal crops. However, peasants may elect to sell them at market freely, provided market prices are set at higher ends. This has led to two prices for the same kind of products from the same producer. In reality, rural households failed to accomplish the state’s planned quotas; instead, cereal crops were centralized in the hands of some few rural households, which sold them in large quantities at prices being higher than the state’s planned prices. Such scene occurred shortly after this system was put into force, and ultimately generated a heavy financial burden on the shoulders of the government.

2. Urban Reform

When rural reform was carried out in full swing, rural reform however made little progress. In spite of the separation of powers in financial matters between the central government and governments at provincial (autonomous region, municipal) levels, the offering of bonuses and other incentives in factories and plants, as well as the allowance of those consumer goods categorized as small commodities being sold in the market directly, the original planned economy system underwent limited changes yet.

In 1984, inspired by the then great harvest of cereal crops and the consequent increase of peasants’ earnings, the then Chinese government determined to push forward its urban reform, and established its reform policy in the unambiguous form of a resolution reached by the 3rd Plenary Session of the 12th Central Committee of the Communist Party of China. This resolution pointed out clearly that “reinvigorating enterprises (namely corporate reform) is the pivotal link of the entire reform into the economic system”, and that “the reform into the pricing system is the key to the success of the entire reform into the economic system”. Meanwhile, this resolution claimed that “it is necessary to attach importance to macro-regulation, make integrated use of such leverages as price, taxation and credit, etc. so as to adjust the aggregate supply and aggregate demand”. In 1985, the tasks of China’s reform on three fronts (enterprises, pricing system and macro-regulation) were made clearer.

In here, we need to differentiate among the route, reform proposal and actually functioning policy. The “route” means the guiding principle, which is usually specified in the written report of the National Congress of the Communist Party of China which is held once in every five years, and also in the written resolution reached by the Plenary Session of the Central Commission of the Communist Party of China which is held once in a year. For example, the 12th National Congress of the Communist Party of China (held in 1982) put forward a reform principle featuring “planned economy play a lead role, and market regulation do a support role”. The 3rd Plenary Session of the 12th Central Committee of the Communist Party of China (held in 1984) drew an inference going as “planned commodity economy on

the basis of the socialist public economy". The 13th National Congress of the Communist Party of China (held in 1987) put forward that "China still remains in a primitive stage of her socialism", and redefined the socialism of hers. The 14th National Congress of the Communist Party of China (held in 1992) defined the objective of reform clearly as to "establish a socialist market-oriented economy system". The clarification of such objective and guiding principle is a result of theoretical analysis and practice summarization, and reflects the common understandings reached by the Communist Party of China and the Chinese government, while serving as the basis of specific reform proposals and measures.

Each year, the Chinese government announces the specific reform scheme, which is an integration of suggestions on reform hailing from all walks of life and often involving concerns on many fronts. Without doing so, there will be no basis whereon governments at various levels may act. However in this reform scheme that seems all-inclusive, the truly functioning policies are only a few ones concerning the objectives and tasks of the reform.

From 1978 to 1992, policies with regard to pricing, enterprises and macro-economic reform included the dual pricing system, enterprise accountability system and separation of financial powers.

(1) Pricing reform: a combination between deregulation and regulation, accompanied by a dual pricing system

Although China determined her pricing system to consist of three elements, namely, planned price, guiding price and market price, as early as in 1982, there have been no clear indications of the scope of planned price and that of market price, how the guiding price is set, and how to make a transition amongst these three elements. The practice is to progressively lift the ban on the prices of, and apply market prices on, those kinds of consumer goods and agricultural products that are produced in more varieties and also in relatively small quantities as far as each variety is concerned. The prices of some consumer goods which are received by a large population, such as non-staple foodstuffs supplied in urban areas (1982), vegetables (1985), cigarettes (1986) and liquor (1987), etc. were adjusted before being subjected to less control. Those important means of production, such as steel, coal and important agricultural products, were however governed by a dual pricing system, under which those products produced according to the state's general plan were priced by the state, and those extra outputs might be priced according to the market needs. Such a pricing system arose on the basis of China's practice. In 1960, in order to cope with starving and grave shortage of foodstuffs, Chen Yun, one of the then Chinese leaders, led the implementation of a successful program to increase the purchasing prices of those foodstuffs beyond the stipulated quotas. Snacks and candies, which were excluded from purchasing at increased prices, and such industrial means of production as steel and coal have all been marketable in local markets of industrial products. These practices were generalized on a symposium attended by youngster scholars and held in 1984 as a "combination between regulation and deregulation", and later defined as a "dual pricing system". Relevant suggestions, which corresponded with previous practical experience, drew immediate attention from and were thus echoed by the leaders in the State Council, hence becoming the important components of the price reform started at the end of 1984.

China's implementation of the dual pricing system ever aroused wide-spread disputes at home and abroad. Throughout the second half of the 1980s, the Chinese government, while effecting its reform for the purpose of introducing the dual pricing system, always tried to integrate the means of pricing. Therefore, the general public began to develop expectations for inflation, which resulted in a failure of the government's efforts in integrating the means of pricing. Only until early 1990s, the macro-economic situation was stabilized relatively, urban and rural residents earned more, most commodities had their prices set in view of the market demands, the government enhanced the selling prices of cereal crops and then lifted the ban on these selling prices, and increased the planned prices of coal while introducing the market prices for the sale of coal. Since there were no market fluctuations and social turbulences at that time, the government completed its reform into the prices of main agricultural products and principal means of production.

(2) Implementation of an operational responsibility system across State-owned enterprises

Heads and managers in enterprises were granted greater powers to act in their own discretion. Corporate incentive programs allowed managers and employees to receive rewards out of the profit growth once they accomplish the preset quotas. Such measures were commenced in 1983. But shortly after that, it was discovered that managers of state-owned enterprises were at an advantage during negotiations, featuring one-on-one bargaining, on the confirmation of the specific tasks of contracting for business operations. In addition, as corporate managers are in possession of a relatively full

package of information, although they were required to render their personal properties as collaterals, they were still unable to bear the losses sustained by their enterprises. Ironically, the thing was like this: corporate managers earned more than employees when their enterprises made profits, but did not bear the losses sustained by their enterprises (such losses were borne by the state). Therefore, the corporate management responsibility system was still in a pilot stage and underwent ups and downs, at that time.

But in 1987, the Central Government, which was faced with the then slowing-down pace of economic growth and decrease of financial revenues, decided to carry out a corporate management responsibility system across the board. For being respectively staffed with smart managers and relatively low planned task quotas, Shougang Group and a few other enterprises in Beijing succeeded in carrying out their reformative measures on a pilot basis. The market situation featuring “demand beyond supply by and large” in the 1980s also allowed enterprises to increase their production outputs. Because an overwhelming majority of products were in short supply, enterprises could sell whatever they managed to produce, which was well known as a prevailing scene at the then market. Therefore, within a short period of time, the corporate management contracting-out system did help increase the production output.

At that time, state-owned enterprises and collectively owned enterprises also tried to turn themselves into non-governmental players, and conducted tests in regard to selling-out, leasing and bankruptcy, thus drawing wide attention from the outside. However, due to restrictions in ideological terms, and because there was no corresponding social security system to offer assistance, these tests were conducted in a rather careful way, and made not so evident progress.

The real innovation of the enterprise system is the addition made thereto. In rural areas, a lot of laborers have to be transferred, owing to the freedom in acquisition of labor forces and arable lands can only host a limited number of laborers. Therefore, there occurred a horde of industrial processing enterprises embarked on by township governments, collective bodies or individuals in townships and villages. These enterprises had no lack of lands and laborers, purchased their raw materials from more sources and expanded their product markets with the implementation of the dual system. Some self-employed players began to employ workers in consequence of the expansion of their operation scales, thus drawing attention from the society. Deng Xiaoping offered his timely appraisal going as “township enterprises are rising suddenly and shall receive support”; meanwhile, private enterprises were allowed to be established and to employ laborers. As a fruit, collectively owned and non-governmental enterprises in rural areas were thus protected and gained swift developments.

In urban areas, due to the poor employment scene, the Chinese government started to encourage individuals to embark on small businesses and register themselves as self-employed laborers of industry and commerce as early as in 1982. A large number of these self-employed laborers soon became active in the retailing, wholesaling and catering sectors of the service industry. In the latter part of the 1980s, some of these small businesses grew into enterprises each employing more than 8 persons, and thus became privately run enterprises defined by the Chinese government.

The developments of these enterprises located in rural areas and urban areas and not owned by the state have helped foster a truly competing market, thus laying down a foundation for the subsequent reform into the state-owned economy realm into further depth.

Table 1: Proportions taken up by various economic components in the aggregate industrial output

| Year | 1978 | 1980 | 1985 | 1990 |
|--------------------------------|------|------|------|------|
| State-owned Enterprises | 77.6 | 76.0 | 64.9 | 54.6 |
| Collectively owned enterprises | 22.4 | 23.5 | 32.1 | 35.6 |
| Other types of enterprises | | 0.5 | 3.0 | 9.8 |

Data source: “China Statistical Yearbook” (by year)

Table 2: Proportions taken up by various economic components in the sales revenue of retailing trade

| Year | 1978 | 1980 | 1985 | 1990 |
|--------------------------------|------|------|------|------|
| State-owned Enterprises | 54.6 | 51.4 | 40.4 | 39.6 |
| Collectively owned enterprises | 43.3 | 44.6 | 37.2 | 31.7 |
| Other types of enterprises * | 2.1 | 4.0 | 22.4 | 28.7 |

* Other types of enterprises include privately run enterprises and foreign funded ones

Data source: "China Statistical Yearbook" (by year)

(3) Reform into the macro-economic management system

Under the planned economy system, national finance was founded on a distorted pricing system and state-owned enterprises' payments out of their profits. At that time, the national revenue and governmental functioning were guaranteed by low-priced agricultural products and means of production and also by high-priced industrial consumer goods as well as by the corresponding taxation system.

However, when the pricing system, enterprise management system and ownership mix underwent changes, the government's taxation system had to be changed accordingly. As the pricing system and enterprise system were both changing, the Chinese government resorted to the transfer of powers to local governments in an end to mobilize their initiatives and to ensure its financial revenue at the same time. Starting from 1980, China put into force an income distribution system between the central government and local governments (namely, a separation featured financial system), and arranged state-owned enterprises, according to their affiliations and ownership vesting, to make payments out of their profits to the central government and local governments respectively. Those corporate profits subject to control by the central government were called the revenue of the central government, whilst those corporate profits subject to control by local governments were retained by local governments. Other tax revenues were divided, according to tax varieties, into the central government's tax revenue and local governments' tax revenues, so as to augment the financial powers of local governments and encourage local governments to embrace more revenues. Starting from 1983, China effected a transition from "rendering of profits" to "payment of taxes", which meant that state owned enterprises no longer rendered certain portions of their profits to the government, and were instead requested to pay income taxes so as to ensure the financial revenue of the government. However, on the one hand, China granted an increasing amount of financial subsidies; on the other hand, the proportion taken up by financial revenue in national income was dropping at a growing pace. In 1988, the central government started to put into force a financial responsibility system, under which many methods were employed to determine the specific contributions to be made by different local governments in view of their historical revenues and obligations of payment to the central government. Among these methods, some determined fixed proportions to be contributed by local governments, most others allowed local governments to retain a better portion of their extra incomes. Such a mode of distribution that features "earn more, retain more" is, evidently, able to offer stronger incentives to those provinces where the economy grew at a faster pace. Later on, provincial governments disseminated such responsibility system into their governed cities and counties. As a result, the central government gained stable basic income, whilst local governments at all levels received stronger financial incentives to develop their regional economies.

The main task of macro-economic management is to smoothen the economic cycle. Due to a short supply of commodities, softening of budget restrictions on state-owned enterprises and impulses of governments at all levels for pouring investments, the main task of macro-economic management in the course of reform is to counteract inflation. In 1980, China experienced an investment inflation. In 1985, another fit of inflation was incurred because of the discontinuance of control of the prices of certain products, pay rises and loss of credit control, and did not end until 1988. After 1980, the Chinese government adopted such measures as control of capital construction investment. Meanwhile, due to agricultural harvests for consecutive years, the information was quickly put under restraint. After 1985, the anti-inflation measures taken under the pricing reform were not timely and powerful, the Chinese government even imagined, in 1988, an option of swiftly carrying the pricing reform into depth in the context of inflation and setting prices "beyond the pale". The unfortunate consequence was that the then inflation deteriorated, panic people swarmed into shops for shopping and ran on banks. As a result, the Chinese government had to take such measures as linking the deposit interest rate with the inflation rate and also to employ such administrative means as restricting the withdrawal of deposits, thus managing to check the wheels of inflation but at the price of a palpably decreased pace of her economic growth.

3. Opening up to the outside

One of the reasons of China's reform is her finding, as a result of a comparison between China and other countries and territories, particularly Japan, South Korea, Singapore, Taiwan and Hong Kong in her vicinity, that the gaps between China and these countries and territories in terms of development

were widening. This aroused profound worries in the minds of the then Chinese leaders, who then set off to seek changes. Later, the Chinese government decided on a guiding policy of opening up to instead of being secluded from the rest of the world.

In 1980, the Chinese government started to encourage foreign businessmen to invest in her territory, and approved the establishment of four special economic zones, i.e. Shenzhen, Zhuhai, Shantou and Xiamen, which are adjacent to Hong Kong, Macao and Taiwan respectively. In these four zones, more open policies were put into force. Subsequently in 1984, 14 coastal or port cities in China were approved to open themselves to the outside. In 1987, the Chinese government adopted further measures (collectively called as a development strategy for coastal regions characterized by “large input and large output”) to encourage the developments of such trading means as foreign investment, processing with supplied materials.

Opening up intensified the link between China’s economy and world economy, and boosted the development of her export-oriented economy. With the positive evolvement of foreign trade and foreign investment, light has been shed on the institutional shortcomings existing in China’s economy that caused China not to adapt herself well to the market economy scene, such as administrative over-intervention by the government and imperfect system of laws and regulations, etc. This has also boosted the further evolution of China’s reform.

4. Discussion: pricing reform – transition of the “dual system” or a “full package of supporting measures”?

The “incremental reform” characterized by the dual system has ensured the planned economy system to function still as per the previously set quotas, hence guaranteeing the continual operations of the original production links. Meanwhile, incremental elements flew into the market, providing price signals and incentives for increasing the output and revenue for both enterprises and local governments. Thanks to the existing and developing market, necessary conditions such as raw materials, etc. were provided for the entry made by new collectively owned or privately run enterprises. Therefore, a market economy in parallel to the planned economy occurred in China and grew up quickly. For producers, the logic of reform is rather simple, which is “additional products may enter the market and be sold at higher prices, thus benefiting enterprises and individuals”. The reform as such facilitated the then economic growth. Taking the GDP in 1978 as a base number, 1985 posted an economic growth rate of 63%, and 1992 did a growth rate of 201% (see Figure 1). Most of the economic growth flew into the market. Roughly speaking, in 1985, the market oriented economy took up 1/3 of the national economy aggregate, whilst the planned economy took up the other 2/3. Later in 1992 there occurred an inverse scene, in which the market oriented economy took up 2/3 of the national economy aggregate, whilst the planned economy took up only 1/3. Therefore in 1985, it was not the ripe time yet to blend the price planning practice and market-based pricing practice together. In 1992, most elements of China’s economy were actually subject to market adjustment. Time was finally ripe to blend the above two practices in regard to the prices of such industrial means of production as iron and coal, etc.

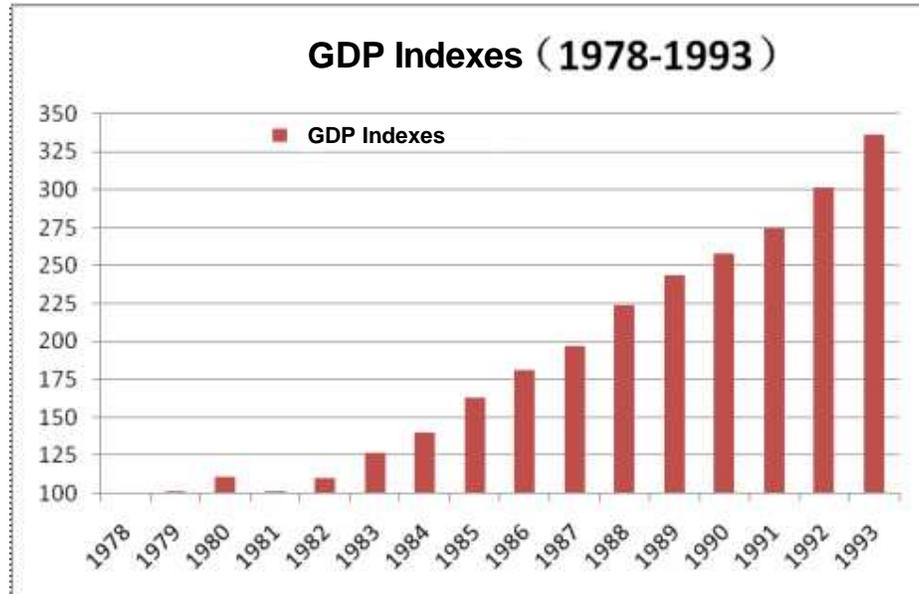


Figure 1: GDP Indexes from 1978 to 1993 (set at 100 in 1978)

Meanwhile, incremental reform accomplished three major objectives, which were growth, transition and stability, which was regarded as a successful creation by China in her course of transition from the planning system to the market-oriented system. Although some foreign economists had long before argued that the dual system of pricing had no negative bearing on the efficiency of resources allocation (Sicular, 1988: 283-307), international organizations, overseas experts and some Chinese scholars waged intermittent fits of criticism against such pricing system. Their criticism was principally targeted at those influences, such as rent seeking and corruption, on the society wielded by the reform. Although this strategy led to the act of rent seeking⁷ by use of the price differences generated under the dual system, and also triggered off corruptive acts, such acts had to be regarded as the necessary price that China has to pay, when compared to Russia and Eastern European countries where prices were swiftly liberalized and thus caused the production outputs to drop by leaps. In the context of significant reformation in the human society, an infallible mode can only remain a maiden but Utopian dream cherished by a handful of elite members. In the reality, the result of interaction among multiple kinds of social forces is, more often than not, an option for the “second best” alternative.

The “full package of supporting measures” reform is another strategy. Relevant thoughts were put forward as early as in the course of devising the initial reform scheme for China. Until July 1985, it was mentioned unambiguously by the then National Institutional Reform Commission in its reform scheme. The basis was “economic system and economic life are each an organic integer whose components are intertwined closely and restricted in all respects. Reformative measures taken by any department, region and in any realm will influence other respects and will also be subject to the restrictions effected by such other respects. This decides, from the very start, that the reform must be accompanied with a full package of supporting measures. In this respect, East European countries have tendered both lessons and experience which can be said to be of universal reference values”. Therefore, it was stated that “it is necessary to change the dual system and multi-track system into a singular system, and implement a market-oriented pricing system under the guidance of planning” (the then National Commission for Economic Restructuring, 1988).

It needs to be pointed out that in 1985 when this proposal was put forward officially, it was only half a year since the reform into the dual system on the pricing of means of production was put into force, if taking account of the course of discussions and formulation of a full package of supporting measures, it is fair to say that this proposal was put forward almost at the same time when the dual system was put into force.

⁷ As reckoned by some economists, the proportion taken up by China's aggregate rentals in her GNP was about 20% in 1987, about 30% in 1988 and about 32.3% in 1992 (Hu Heli, 1989: 10-15; Wan Anpei, 1995: 76-81).

There were three attempts at such train of thought, which however have failed for different reasons.

The first attempt was the “pricing adjustment” made on cereal crops in 1985. Before that, as the government increased the purchasing prices of cereal crops, and purchased those produced beyond set quotas at higher prices, whilst the selling prices of cereal crops remained unchanged however, the amount of financial subsidies to cereal crops granted by national finance departments has skyrocketed with the great harvest of cereal crops for 3 consecutive years. In 1984, the amount of such subsidies reached RMB 23.4 billion yuan, occupying 13.8% of the financial outlays in that year. Later, the government decided in 1985 to purchase cereal crops at contractual prices, which are the weighted averages of the originally planned prices and those prices applied to additional products beyond set quotas (the latter), thus being lower than the latter. As marginal prices were lowered, and a reckless change was made in the purchasing mode, peasants received an ostensible signal for the necessity of reducing their production outputs. In addition, the pricing restrictions on other kinds of agricultural products were removed one after another and peasants began to embrace opportunities of being employed in non-agricultural sectors, China’s total output of cereal crops decreased by 6.9% in 1985, and did not get back to the level of 1984 until 1989, in despite of endeavors made in many respects. Such adjustment of the prices of cereal crops was instrumental to reducing the financial subsidies at that time, but planted the seed of future increase of commodity prices. On the premise that urban citizens are rather poorly capable financially, the government, being unable to change the selling prices of cereal crops, elected recklessly to adjust the purchasing prices of cereal crops, which however turned out a failure. Consequently, the government had to resume the dual system to govern its practice in purchasing cereal crops.

The second attempt was the plan for adjustment of the prices of means of production from 1985 to 1986, accompanied by the efforts in working out a balance in terms of interests distribution by means of a linkage between taxation and financial subsidization. This proposal was based on price adjustment, and effected initially by means of planning for all the major means of production. However, the then adjustment proposal was too complicated and hard to finalize. Therefore, the 1986 proposal narrowed down its coverage on the adjustment of iron prices only. Notwithstanding such compromise, it remained a rather tricky task to reckon the averaged prices of iron and how much each province made as gain or loss. The original reform proposal planned to increase the price of straight carbon steel to RMB 1,000 yuan per ton from RMB 693 yuan per ton in 1987, and to have a majority of enterprises’ incomes derived from price differences come out of the state’s taxation practice. Before the government announced its proposal as such, provincial governments and iron & steel enterprises scrambled for increasing their prices. Since the supply shortage was never mitigated, the calling off of the dual system and the effecting of incremental reform led to uncertain proceeds and uncertainties in interests distribution. What was more, since the state government adopted retrenchment measures for the purpose of checking the then inflation, the national economy stepped onto a downward track from the second half of 1986 to the start of 1987. At that time, a delegation whose members were organized by the then National Commission for Economic Restructuring made an inspective tour in Hungary and Yugoslavia as to how these two countries had effected their reforms, and stated in its report strongly that “such a way of reform featuring overall planning and a full package of supporting measures is totally ineffective, because China would adopt the planned economy system without effecting any reform, if the Chinese government had been able to reckon the averaged prices and to adjust the interests distribution scene”. Faced with the harsh fact of dramatic decrease of the economic growth rate, the government dropped such proposal, and went back in 1987 to resume the state- owned enterprise responsibility system and multiple forms of contracting out systems for local players. Until now, some people are still criticizing this change by claiming that the government returned to grasp its “granting powers and distributing interests” train of thought without knowing that a “full package of supporting measures” were totally infeasible. According to them, on the one hand, due to ideological restrictions, such concepts as “market economy” and “labor market” were still objects of criticism at that time, thus rendering it impossible to work out a full package of supporting measures. On the other hand, the order of economic operations could not be damaged, and the economic growth should not be affected. Practices have proven that it is reasonable and feasible to initially grant powers and distribute interests, effect incremental reform, keep expanding the market shares and foster subjects of the market as well.

As too much heed was paid to the weak points of the dual system, while a horde of Chinese and foreign scholars were echoing criticizing the dual system, the Chinese government launched its third attempt of price adjustment after a short period of time, which was the so-called “pricing beyond the pale” in 1988. In the then context of inflation, September 1988 saw the Chinese government announce that it was poised to effect a pricing reform and alter the pricing scene under the dual system. Long

before that, ordinary inhabitants had expectations that a pricing reform signaled price rise. Thus, both urban and rural inhabitants scrambled for purchasing commodities and running on banks. Hence, the government was forced to give up its original plan. This reform was ended before even getting started.

Overall speaking, although the government adopted the dual system and effected incremental reform, it acted in a reckless way to carry forward the reform without conducting due theoretical reasoning of the feasibility and rationality of such reform, and always tried to “design as a whole and arrange a full package of supporting measures”. Such conception, although differing from the “shock therapy” or the early-stage reform in East Europe, was based however on the same assumption going as “economy is an integer, and reform into any part of it will not succeed”. China’s reform, at its inception, was targeted at urban economy, but embraced its success initially in rural areas. China adopted the strategy featuring the dual system in conjunction with incremental reform, but entertained doubts without relinquishing its attempt to “push forward as a whole”. Such a contradictory state is a manifestation of China’s persistent explorations in the sprouting stage of her progressive reform.

II. Stage of integration between market economy and planned economy and also between incremental economy and inventory economy (1992~2003)

After the reform throughout the 1980s, China’s economy grew rapidly. From 1978 to 1990, her GDP aggregate recorded an annual average growth rate of up to 14.6%. Meanwhile, the non-state economy (comprising collective economy and non-public economy) also evolved fast and took up an expanding portion of the national economy and even garnered a significant position. The economic activities in the non-state economy sector are conducted under guidance by the machinery of market-based pricing and free trading, and its development is market guided. At the start of the 1990s, beyond the state economy sector there has already formed a regional free market of substantial scale, whilst such market signals as price have become increasingly important in regard to resources allocation and economic activities.

At the start of the 1990s, the pricing reform was almost finished, when market economy coexisted with planned economy. The focus of China’s reform turned to two other important elements of economic reform, namely macro-economic system and reform of state-owned enterprises. The mutual influences and restrictions wielded by different economic sectors, which were all developing, waged new challenges on the economic operations. The strengthening of the non-state economy posed competition pressures on the development of the traditional state economy sector. The low efficiency, poor competitiveness and deteriorating financial conditions of the state economy sector brought forth eye-catching problems, which were: 1) the then national financial revenue was mainly contributed by the state economy sector, whose efficiency was however dropping, which directly led to the deterioration of the country’s financial conditions and caused the government’s resources extracting abilities to weaken; 2) in order to support the development of the state economy sector, financial departments of the country had to invest a lot of resources into the state economy sector, generating greater pressures on the country’s financial expenditure (see Table 3).

Table 3: Proportions taken up by financial revenues and financial deficits in the GDPs from 1978 to 1992

(Unit: %)

| Year | Financial Revenue | Financial Deficit |
|------|-------------------|-------------------|
| 1978 | 34.8 | -0.3 |
| 1981 | 27.3 | 2.1 |
| 1986 | 25.2 | 2.2 |
| 1991 | 18.5 | 3.4 |
| 1992 | 14.2 | 3.4 |

(Data source: Wu Jinglian, 2008: 256)

Besides, due to the coexistence of planned economy and market economy in the economy system, the original mode of planned control became decreasingly effective, whilst the mode of macro-adjustment and the mode of economic management that meets the needs of market economy were not established yet. Macro-adjustment means in the context of market economy, such as monetary policy, adjusted and intervened with the economic life in a weak manner, and there was a lack of effective means to maintain the stability of macro-economy.

Therefore, in the 1990s, imminent problems against China's reform were how to integrate the planned economy element and the market economy element in the national economy, reinforce the primary position taken up by the market in economic life, and set up a macro-economic management system that meets the needs of market economy. The reform in that stage was principally to: (1) reform state-owned enterprises and enable them to become efficient modern enterprises and participate in market competitions, and give full play to their lead roles in economic life; (2) reform the taxation system, establish a taxation system that meets the requirements of market economy and establish a separate taxation system applicable to the central government and local governments on the basis of rational division of powers of office in replacement of the previous financial system featuring payment partly in kind and partly in cash; (3) reform the financing system and foreign exchange system, address the needs of market economy and enable the currency and exchange rate machineries to effect macro-adjustment of economic activities; (4) carry out the policy of opening up into further depth, open up the market, introduce the competition mechanism to enhance the competitiveness of enterprises; (5) address the needs of reform into state-owned enterprises and of economic restructuring, set out to formulate new social security policies thus to cope with the large population of laid off (unemployed) workers and financially inflicted urbanites arising in the course of reform. The main objective of reform is to establish a market economy system.

1. Reform into the macro-economic system

In 1993, China's economy grew rapidly. Meanwhile, the inflation pressure loomed rather large. Faced with such a scene, the Chinese government elected to carry forward its macro-economic reform in an all-sided way. Among others, the most important measure was the reform into the taxation system and the exchange rate system.

(1) Reform into the taxation system

As measures of granting powers and distributing interests under the contracting out system were taken towards state-owned enterprises and local governments, local governments and state-owned enterprises garnered a better part of the benefits derived from the economic growth, thus pushing down the proportion taken up by the financial revenue in the national economy aggregate. The proportion taken by the central government's financial revenue in the country's aggregate financial revenue also slid down (see Table 4). Until the start of the 1990s, the central government became hardly able to cover its expenditure.

Table 4: Proportions take up by the central government's financial revenues

| Year | Proportion taken up by the central government's financial revenue in the country's aggregate financial revenue (%) | Proportion taken up by the central government's financial revenue in the country's GDP (%) |
|------|--|--|
| 1985 | 38.4 | 8.6 |
| 1990 | 33.8 | 5.4 |
| 1991 | 29.8 | 4.3 |
| 1992 | 28.1 | 3.7 |

(Data source: "China Statistical Yearbook", by year)

In such a context, the government reeled off some of the expenses of administrative agencies and funds in compulsory education as well as a lot of social security expenditure items from its financial expenditure portfolio, in an aim to alleviate its financial burdens. As a result, these administrative and social causes had to finance themselves by means of self-funding, earning money through creative channels, and meeting the market needs, which are diverse but not standard either. This has, on the one hand, resulted in an imbalance between income and expenditure in spite of budgeting and institutional control. Various kinds of financial appropriations required and unauthorized charges levied have posed heavy pressures on the society, and on the other hand, given rise to distortions in the course of development of the education, medicare causes and other social causes.

To address these problems, China effected an all-sided reform into her taxation system in November 1993. On the basis of the pilot reform aiming to carry out a tax separation system and initiated in 1992, China put into force the tax separation system across her territory from 01 January 1994. Concrete reform measures included:

- To establish a taxation system that meets the needs of market economy pursuant to the principle of a uniform tax law, equitable tax burden, tax streamlining and rational separation of powers. It was

required to carry out a new turnover tax (indirect tax) system under which VAT plays a major role and apply it on all types of enterprises; apply the corporate income tax system which is applicable to Chinese-funded enterprises on enterprises with all types of ownership systems; unify individual income taxes and adjust individuals' incomes by use of an excess progressive system; intensify the management over taxation practices.

-- To clearly differentiate the functions and powers of office of governments at provincial, municipal, county and township levels, and determine the ranges of outlays of governments at all levels. It was required to make a rational division of tax types in accordance with the natures of revenues and also the principle of effective taxation and management, and determine which taxes to be levied by the central government, which taxes to be levied by local governments, and which taxes to be levied jointly by the central government and local governments; and ensure the financial revenue of the central government to take up about 60% of the country's aggregate financial revenue, and ensure the financial expenditure of the central government to take up around 40% of the country's aggregate financial expenditure.

-- To establish a transfer payment system under which the central government transfers 20% of its aggregate financial revenue to local governments serving lower-income regions, so as to shorten the financial revenue gaps among regions.

The reform managed to establish, by and large, a framework taxation system that meets the requirements of market economy, and put to rights the financial distribution relations between the central government and local governments. Following the reform, the proportion taken by the government's financial revenue in the country's GDP climbed up progressively. Among others, the proportion taken by the central government's financial revenue in the country's GDP also tended to be stabilized (see Table 5). Afterwards, the government settled various kinds of out-of-budget revenues step by step, reformed the taxation system and progressively improved its establishment of a public finance system.

Table 5: Proportions taken by the country's aggregate financial revenue in China's GDP and proportions taken up by the central government's financial revenue in China's GDP (1995-2000)

| | Proportions taken by the country's aggregate financial revenue in China's GDP (%) | Proportions taken up by the central government's financial revenue in the country's aggregate financial revenue (%) |
|------|---|---|
| 1995 | 10.7 | 52.2 |
| 1996 | 10.9 | 49.4 |
| 1997 | 11.6 | 48.9 |
| 1998 | 12.6 | 49.5 |
| 1999 | 13.9 | 51.1 |
| 2000 | 15.0 | 52.2 |

(Data source: "China Statistical Yearbook", by year)

(2) Reform into the exchange rate system

As to foreign exchange management, China effected a uniform system of instructive planning management and distribution before the implementation of the policy of reform and opening up. At that time, payments for exports were all settled according to exchange rates set by the government, and the exchange rates of China's home currency were overestimated. After 1979, China progressively eased her control and administration of foreign exchange and put into force a dual system under which official exchange rates coexisted with market exchange rates, and allowed enterprises to retain a certain portion of their earnings in foreign exchange, so as to encourage them to earn foreign exchange. Thereafter, in order to adjust the inter-enterprise foreign exchange surplus or shortage, foreign exchange adjustment service was launched. Between 1987 and 1988, a foreign exchange adjustment center was set up to tap the foreign exchange adjustment market. By the end of 1993, 80% of China's foreign exchange resources have been allocated in the foreign exchange market. In order to coordinate with the export-oriented economic strategy, the exchange rates of Renminbi were falling all the way. In 1993, the official exchange rate of RMB against USD was 5.7:1; but in the foreign exchange adjustment market, such rate ever reached 10:1.

In 1994, China effected a significant reform into her foreign exchange management system, integrated the official exchange rates and the exchange rates in the foreign exchange adjustment market (i.e.

putting an end to the dual exchange rate system) and established a market-demand-based, singular and regulated floating exchange rate system. In December 1996, China made an official acceptance of Article 8 of the Agreement of the International Monetary Fund by realizing the convertibility of Renminbi under current accounts. Thereafter, in Asia's financial crisis starting from 1997, China persisted in stabilizing the exchange rates of RMB, thus giving powerful support to the rebound of other economies.

Although the exchange rates of RMB against other currencies were lowered down slightly thereafter, the US and major countries in Europe imposed gigantic pressures on the Chinese government with a request for the acceleration of RMB revaluation, owing to the constantly growth of China's foreign trade surplus. With the variations in the trading situation, starting from 21 July 2005, China put into force a regulated floating exchange rate system which is based on the supply-demand relation in the market and also subject to adjustment by reference to a basket of currencies.

2. Reform into state-owned enterprises and state-owned banks

(1) Reform into state-owned enterprises

In 1988, state-owned enterprises began to reform their operating system on a trial basis, by means of adopting such practices as "linkage between wages and economic benefits", "employment contract" and "dismissal system", in an effort to usher in an internal incentive mechanism to strengthen their management and enhance their competitive forces. At the start of the 1990s, this train of thought of reform was still in application, and the then focal task of reform was to break down the three previous systems as to employment, personnel and wages, have such matters as cadre personnel, labor employment and wages distribution handled by enterprises in replacement of government agencies, transform state-employed personnel into enterprise employees, have wages and salaries of personnel set down by enterprises, in replacement of government agencies, according to labor services, implement cadre personnel systems in enterprises wherein competent talents are promoted and engaged and incompetent ones are demoted or even dismissed, and put into a wages distribution system under which competent talents are paid more and incompetent ones are paid less. This reform was called by the public as a "smashing of three stable things" (stable job, stable position and stable wages), and touched upon the core interests of staff members and workers of enterprises, thus encountering oppositions waged by staff members and workers of enterprises under the then social situation wherein staff members and workers were not provided with basic social security services. The Chinese government had to discontinue this reform because of worries about social stability.

From 1990 to 1995, the aggregate output value of state-owned industrial enterprises climbed to RMB 3,122 billion yuan from RMB 1,306.4 billion yuan, recording an average annual growth rate of 18.4%. However, while the state-owned economy sector was gaining an expanding scale, its economic efficiency was not enhanced at the same pace. During that period of time, in order to increase the size of employed population, state-owned institutions saw their total headcount increase by 11.15 million persons (see Table 6). State-owned enterprises recorded low efficiencies and even recorded severe losses. In 1997, more than 40% of those state-owned industrial enterprises which conducted business accounting independently posted losses, totaling up to RMB 83.1 billion yuan; whilst their total profits were only RMB 42.8 billion yuan, thus leading to a total loss of RMB 40.3 billion yuan. Among these money-losing state-owned enterprises, large players recorded losses in a limited variety of their business activities and registered relatively low loss rates. In contrast, small players recorded losses in a relatively large variety of their business activities and registered higher loss rates than large players did.

Table 6: Total employed population sizes in cities and towns and total headcounts of state-owned institutions from 1978 to 1995

| Year | Employed population size in cities sand towns | Total headcount of state-owned institutions |
|------|---|---|
| 1978 | 9514 | 7451 |
| 1980 | 10525 | 8019 |
| 1985 | 12808 | 8990 |
| 1989 | 14390 | 10108 |
| 1990 | 17041 | 10346 |
| 1991 | 17465 | 10664 |
| 1992 | 17861 | 10889 |

| | | |
|------|-------|-------|
| 1993 | 18262 | 10920 |
| 1994 | 18653 | 11214 |
| 1995 | 19040 | 11261 |

(Data source: "China Statistical Yearbook 2005")

"Unleash the powers of management over medium and small sized enterprises"

The failure in enhancing the operating efficiencies of state-owned enterprises directly caused the government to necessarily provide subsidies constantly to state-owned enterprises for the purpose of keeping them running, thus constituting gigantic pressures on the government's financial agencies. To mitigate such financial burdens, the central government devolved the powers of management over a number of medium and small sized enterprises to governments at provincial levels or lower levels. In order to alleviate their own financial pressures, local governments in Zhucheng of Shandong Province and other places began to explore such options as a shareholding responsibility system to reform state-owned medium and small enterprises, and reformed the ownership systems in an effort to enhance their operating efficiencies and competitive forces in the market. In 1994, the Chinese government started to allow state-owned enterprises located in 18 pilot cities to file for bankruptcy pursuant to certain proceedings. The number of such pilot cities was increased to 51 in 1995 and further to 110 in 1997. After going bankrupt, these state-owned enterprises had their assets used to pay their staff members and workers by priority, and then to repay their debts. This is China's unique arrangements under her bankruptcy system. Meanwhile, the government's financial agencies allocated specific funds to offset banks' losses out of bad debts thus incurred.

In order to solve the losses of small state-owned enterprises, the central government decided in September 1995 to adopt a reform strategy featuring "intensify the management over big players and unleash the management over small ones" as to the reform of state-owned enterprises, and focus its efforts on reinvigorating those medium and big sized, backbone state-owned enterprises which must be subject to control by the state and whose operating results concern the national economy and the people's livelihood, unleash the management over those medium and small state-owned enterprises engaged in ordinary productive and competitive fields, and enable them to reinvigorate themselves by means of merger, leasing, contracting out, selling or even bankruptcy, and also mobilize them to re-organize themselves under the guidance of market-given signals and the law of market economy, so as to cause a reasonable flow of resources and elements and to allow those competent players to win the game and those incompetent ones to be washed out (by Wu Jinglian and Zhang Chunlin, 1995).

After the policies and their intentions were made clear, the strategy of "unleashing the management over small state-owned enterprises" received support from local governments. Because on the one hand, this was instrumental to alleviating the financial burdens brought forth on local governments due to the losses of state-owned enterprises, and on the other hand, local governments could gain certain benefits by way of selling out state-owned assets. Therefore, after a quite short period of time, a large number of medium and small state-owned enterprises were dealt with by means of restructuring, amalgamation, merger, leasing, contracting out and joint shareholding as well as selling, etc. The state-owned economy sector decreased its coverage and withdrew from ordinary competitive fields. This not only changed the previous scene in the state economy sector characterized by a large coverage, poor focusing and low efficiency, but also proffered a wholesome climate for the good of healthy development of market economy in relevant fields. The number of state-owned enterprises in China dropped to 127,000 at the end of 2005 from 254,000 in 1997, recording an average annual decrease rate of 8.3% (Zhang Delin, 2007: 147).

Table 7: Profiles of state-owned industrial enterprises and proportions taken up by them in the total number of industrial enterprises in China

| Enterprise | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|-------|-------|-------|-------|-------|
| Number of state-owned enterprises (10,000) | 11.80 | 12.76 | 11.00 | 6.47 | 6.13 |
| Proportion in the total number of enterprises (%) | 1.6 | 1.6 | 1.4 | 0.8 | 0.8 |
| Total output value of state-owned industrial enterprises (RMB 100 million yuan) | 31220 | 36173 | 35968 | 33621 | 34855 |
| Proportion in the aggregate industrial output value (%) | 34.0 | 36.3 | 31.6 | 28.2 | 27.3 |
| Assets of state-owned enterprises (RMB 100 million yuan) | 47472 | 52757 | 59108 | 74916 | 80472 |

| | | | | | |
|---|------|------|------|------|------|
| Proportion in the aggregate industrial assets (%) | 59.9 | 58.6 | 57.1 | 68.8 | 68.8 |
| Growth rate of the total output value of state-owned industrial enterprises (%) | 8.2 | 5.1 | 1.0 | 0.1 | 8.8 |
| Growth rate of the aggregate industrial output value (%) | 20.3 | 16.6 | 13.1 | 10.8 | 11.6 |

(Data source: "China Statistical Yearbook 2000")

"Intensifying the management over big players"

While the state economy sector decreased its coverage and the powers of management over small and medium state-owned enterprises were unleashed, efforts were made continually in carrying into further depth the reform into large state-owned enterprises and enhancing their efficiencies.

As early as in the start of the 1980s, the restructuring of state-owned enterprises according to the modern corporate system became a topic repeatedly discussed in the course of China's then reform. In 1984, a report of World Bank on China's reform ever put forward this train of thought⁸. Afterwards, Chinese economists also discussed the possibility of reforming state-owned enterprises through the joint stock system (Li Yining, 1987). After those reform measures, such as devolving powers of management, distributing interests, and transforming the operating management mechanism of enterprises, each turned out a failure, state-owned enterprises also started to explore the possibility of reforming themselves pursuant to the corporate system. In 1993, China unambiguously defined the objective and orientation of the reform into state-owned enterprises as "to establish a modern enterprise system featuring clear-cut ownership right, unequivocal division of powers from responsibilities, separation of governmental functions from enterprise management, and scientific management practices".

In the course of the reform into state-owned enterprises in the 1990s, main difficulties encountered included: heavy debts and high debt ratios, subsistence funds for staff members and workers of enterprises being granted by their respectively served enterprises, and social benefit funds for staff members and workers of enterprises also being paid by their respectively served enterprises. All these outlays caused enterprises to bear heavy social burdens. Besides, most enterprises were then over-staffed. In order to solve these problems, the reform of state-owned enterprises comprised a series of measures, including lay-off, branching off, payroll cut and efficiency enhancement, all intended to mitigate enterprises' social burdens. In 1997 when Asia's financial crisis burst out, over 13 million staff members and workers were laid off by state-owned industrial enterprises alone. As a result, the headcount of staff members and workers in state-owned enterprises dropped dramatically (see Table 8).

Table 8: Changes in the headcount of staff members and workers of state-owned industrial enterprises

| Enterprise | 1995 | 1996 | 1997 | 1998 | 1999 |
|--|------|------|------|------|------|
| Headcount of staff members and workers of state-owned enterprises (10,000 persons) | 4397 | 4278 | 4040 | 2721 | 2412 |
| Proportion in the total headcount of industrial enterprises (%) | 66.5 | 66.3 | 65.0 | 57.2 | 54.5 |

(Data source: "China Statistical Yearbook 2000")

After the train of thought as to enterprise restructuring pursuant to the corporate system was made clearer in 1997 and 1999, the reform into state-owned enterprises entered a new stage of establishment of a modern enterprise system. This stage consisted of three tasks: 1) corporate reorganization and ownership transformation: monopolistic enterprises were disintegrated or reorganized into competitive enterprises; 2) enterprise reorganization for listing on the stock market: public investors and strategic investors were introduced to break the sole proprietary ownership by the state, and supervisory measures of the capital market were applied to standardize corporate operations. Thirdly, governmental agencies were reformed, governmental functions were separated from enterprise management, and the state-owned assets management system was improved. In

⁸ According to this train of thought in the World Bank report, the reform pursuant to the joint stock system can alter the corporate property system monopolized by the state, enable the formation of a diversified ownership system within state-owned enterprises, improve the governance structure of state-owned enterprises, give incentives to and effect restrictions on shareholders, boards of directors and managements effectively (World Bank, 1985; Lu Mai, 2002).

addition, state-owned commercial banks were also reformed in an aim to put to rights the sources of loans issued to state-owned enterprises, thus progressively solving the “soft budget restrictions” problem encountered by state-owned enterprises.

Through the ownership transformation, the number of those loss-making medium and small state-owned industrial enterprises dropped to 4,391 at the end of 2000 from 6,599 in 1997, thus the objective of “helping them out of poverty” was accomplished. Such reform into medium and small state-owned enterprises pursuant to the corporate system has indeed improved the operating conditions of state-owned enterprises.

Setting of “three security lines”

With the acceleration of the reform into state-owned enterprises and that of economic restructuring, the headcounts of state-owned enterprises and those of collectively owned enterprises dropped dramatically. In particular after the onset of Asia’s financial crisis, even greater adjustments were made into the economic structure and employment scene. In 1997 and 1998 alone, the total headcount of state-owned enterprises and collectively owned enterprises was cut down by 32.39 million persons (see Figure 2).

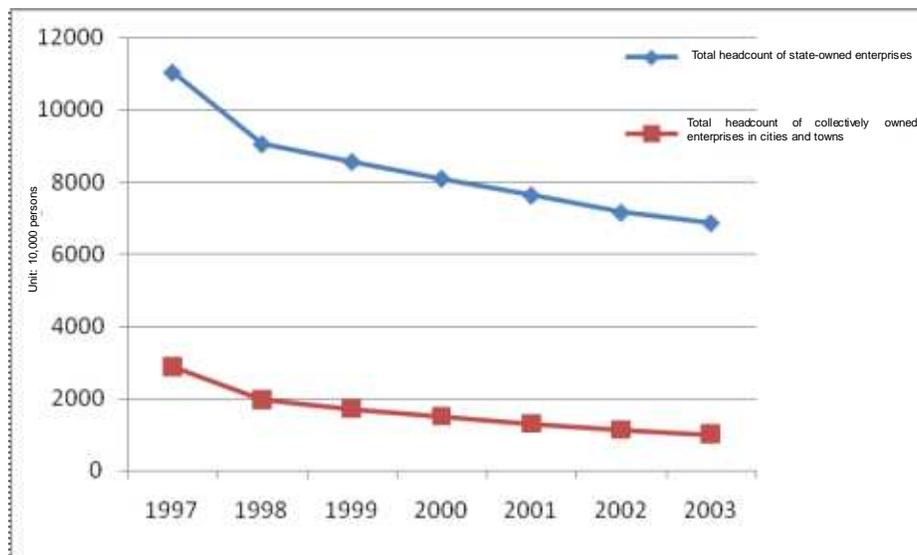


Figure 2: Headcounts of state-owned enterprises and headcounts of collectively owned enterprises in cities and towns from 1997 to 2003

(Data source: “China Statistical Yearbook 2006”)

The traditional planned economy system never acknowledges the fact of unemployment, and the then government did not offer social security for the unemployed population. Although in the late 1980s and early 1990s, the government already started to establish an unemployment insurance system step by step, this system had a rather small coverage. To cite 1996 as an example, in that year, the size of China’s unemployed population was 5.33 million persons, and the size of China’s laid-off staff members and workers⁹ was 8.15 million persons. However, only 24% of them were covered by unemployment insurance. Faced with such fresh challenge, the government laid down a policy featuring “three security lines” in order to ensure the progression of the reform without a hitch and to maintain social stability.

The so-called “three security lines” refers to three basic systems for the laid-off employers of

⁹ Laid-off staff members and workers refer to those staff members and workers who have lost their previous jobs in state-owned enterprises or collectively owned enterprises, but still maintain their labor relations with their previous employers, and are subject to re-employment or other assignments arranged by their previous employers, or those staff members and workers who still maintain their labor relations with their previous employers, and have been arranged by the re-employment service centers set up by the government to serve other state-owned enterprises or collectively owned enterprises. From 1996 to 2000, the total number of China’s laid-off staff members and workers per annum was close to 10 million persons, exceeding the total number of those unemployed persons whose names have been registered.

state-owned enterprises with regard to their livelihood security, unemployment insurance and subsistence security for urbanites. Through these three systems, the country offered unemployment security and subsistence security services for laid-off employees and the unemployed population, not only offering financial aid to those residents in financial plight, but also facilitating the maintenance of social stability and smooth progression of economic reform. To cite 2000 as an example, in that year, 6.5 million employees laid off by state-owned enterprises received livelihood subsidies, whilst 3.3 million unemployed persons received unemployment security payments, and over 3 million urbanites in poverty received subsistence subsidies. The total headcount of these people occupied 6% or so of the total size of employed population in cities and towns in that year (Wang Yanzhong, 2007: 200-201).

(2) Reform into state-owned banks

Since its establishment in the 1950s, China's financial system has served the country's economic strategy that prioritized the development of the heavy industry, and constituted a component part of the then highly centralized system of planned economy. After China adopted the policy of reform and opening up, the reform into her financial system was put onto the table for discussions, in a purpose to alter the traditional system featuring "financial planning in lieu of financing". After that, four major state-owned proprietary specialized banks, namely Agricultural Bank of China, China Construction Bank, China Investment Bank and Industrial & Commercial Bank of China, were progressively transformed into state-owned commercial banks.

The reform into state-owned banks was closely linked with the reform into state-owned enterprises. In 1985, the country effected a "loans in lieu of financial allocations" reform towards state-owned enterprises, in order to strengthen the economic responsibilities of state-owned enterprises, and requested enterprises in need of investments to ask for bank loans in stead of asking for financial allocations for free. This reform was originally intended to try to urge enterprises to develop an awareness of economic accounting as to their investments and fund spending. However, one direct consequence thus incurred was to offer loans to those state-owned enterprises performing at low or poor efficiencies, thus causing banks to bear a lot of bad assets. In 1994, the country established three professional policy banks to take charge of the policy-related credit business which was previously handled by specialized national banks, so as to reduce the policy-related and instruction-based loans¹⁰ granted by the four major commercial banks.

After the reform into state-owned enterprises had its basic objective defined, in order to deal with those bad assets accumulated in state-owned commercial banks before the start of the reform, the central government adopted measures in succession, in spite of Asia's financial crisis in 1997, to reform state-owned commercial banks. Firstly, in 1998 the Financial Department issued extraordinary government bonds worth RMB 270 billion yuan to supplement the capital funds of the four state-owned commercial banks and to allow these four banks to push their capital adequacy ratios to 4%, as per the standard applicable in the year of 1996. Secondly, in 1999 and 2000, four major asset management corporations were founded to acquire bad assets, totaling RMB 1.3 trillion yuan, of state-owned commercial banks. In addition, the four state-owned commercial banks had their organization charts streamlined as well for the purpose of improvement of their managerial performances.

In 2002, the government voiced a reform into state-owned proprietary commercial banks pursuant to the joint stock system. Thereafter, such state-owned commercial banks as Bank of China, China Construction Bank, Industrial & Commercial Bank of China, Agricultural Bank of China each initialized a reform pursuant to the joint stock system, and each introduced strategic investors from abroad for shareholding purpose, thus putting a radical end to the singularity in terms of ownership structure of state-owned commercial banks. Furthermore, they got listed in Chinese and foreign capital markets so as to further improve their equity structures and accept the market supervision and regulation.

3. Discussion: Reform into state-owned enterprises -- "Intensify the management over big players while unleash the powers of management over small ones" or fast pursuit of all-sided privatization?

The Chinese government wisely pointed out that the reform into state-owned enterprises was the core of China's reform into her economic system, and that her national economy could not grow without healthy and vibrant enterprises.

¹⁰ This reform into state-owned commercial banks has facilitated the reform into state-owned enterprises and forced state-owned enterprises to alter their operating mechanism featuring an excessive reliance on bank investments.

China exercised much prudence when reforming her state-owned enterprises. After explorations for over 10 years, China launched a reform policy known as “to intensify the management over big players while unleash the powers of management over small ones” in 1995. Just like the “dual pricing system” reform, this policy became a key step, with very strong Chinese characteristics, in China’s reform into her economic system. Specifically, “intensify the management over big players” means transforming giant state-owned enterprises according to the corporate system, and “unleash the powers of management over small ones” means transforming millions of state-owned enterprises and collectively owned ones into non-governmental players.

While refusing to pursue all-sided privatization, the Chinese government acknowledged realistically that it was impossible for a government to manage well millions of state-owned and collectively owned enterprises, medium sized or small sized, which explained why it resorted to unleash the powers of management over small players. When the powers of management over these enterprises were shifted to the hands of their respective managers, employees or external investors, local governments gave a loudly sigh, signaling the mitigation of their pressures, as they did not need to subsidize these loss-makers any longer. Most of these enterprises, after the shifting of their managerial powers, registered better operating results, to every one’s relief.

Due to the information asymmetry between the government and enterprise managers, undervaluation of assets became an oft-seen scene when the property rights of state-owned or collectively owned enterprises were transferred or assigned, thus arousing fierce criticism from the outside. It was believed that such practice led to the loss of a huge amount of state-owned assets. It is fair to say that it was an inevitable option to transform these state-owned players into non-governmental ones. In the context of market economy, as owners of private enterprises earn and spend much more, thus setting an exemplary role for others to follow their suit, and also due to the inducement by various chances for bribery and corruption, it is impossible for the government to locate millions of management professionals who are not only good at operating management but also dedicated to sacrificing themselves, or to conduct effective supervision and grant powerful incentives to all of them. Local governments at three levels (province, city and county) and township governments have transformed those state-owned enterprises under their management and those collectively owned enterprises affiliated to them respectively into non-governmental players. These acts were done not pursuant to the creed of private ownership right under the western economics, but on the basis of China’s realistic situation. Privatization of these enterprises enables the government to not only gain returns on their investment, but also collect taxes on these enterprises after they run themselves normally. Therefore, it is a rational economic act to grant certain discounts on the occasion of transfer or assignment of the managerial powers over these state-owned enterprises, so as to ensure them to keep running for long.

It goes without saying that state-owned enterprises can be transformed pursuant to the corporate system. In the world, many countries have subjected their public sectors to the corporate governance system, such as the Port Authority of New York and Tennessee Valley Authority in the US and Temasek Holdings Pte. in Singapore, etc. Chinese scholars further clarified, in the subsequent discussions, their suggestions on the transformation of state-owned enterprises according to the joint stock system, and launched a theoretical analysis pursuant to the modern enterprise system and the corporate governance structure in the early 1990s, thus carrying these discussions into depth. By the start of this century, the reform into state-owned giant corporations and state-owned banks was finished under guidance by this train of thought, and China established a State-owned Assets Supervision and Administration Commission, which bears the responsibilities of contributors and dispatches supervisors to supervise target enterprises. In the meantime, individual directors and foreign strategic investors were introduced to consummate the internal corporate governance structures within enterprises. The management of state-owned enterprises were subject to a performance evaluation system and also a corresponding incentive mechanism. These policies and measures altered the state government’s traditional mode of management over state-owned enterprises, and transformed state-owned enterprises and state-owned banks into state-held or state-held enterprises with a mixture of ownership systems. Besides, these enterprises had their governance structures changed significantly, and registered evidently ameliorated operating results within a rather short period of time. The state’s years of investment, the vast Chinese market, the widespread network of banks, and the solid scientific research forces of state-owned enterprises have all translated into component parts of corporate values under the fresh operating mechanism. Faced with a large number of mergers and acquisitions conducted by foreign multinationals in the context of globalization, people cannot help getting worried of the fate of Chinese companies. Will these poorly competitive state-owned companies boil down to component parts of foreign players in their global layout plans, or strive for living under gigantic pressures posed by their foreign competitors? However, once these state-owned commercial

and industrial enterprises and state-owned banks accomplished their transformation pursuant to the corporate system, they managed to redefine themselves thoroughly, like a wonder. One decade, people were talking about the bankruptcy of state-owned banks. After a lapse of 10 years, China's three major commercial banks have been listed in the first three places globally in terms of stock market value, and have still functioned stably in spite of the impacts wielded by the world's financial crisis. Most big state-owned companies have seen their operating results go up and down; however, overall speaking, they have been improving all the way.

However, if China had acted pursuant to the creed of privatization advocated by some people at home and abroad, such as the mode of Latin American countries featuring the sale of their state-owned enterprises to foreign multinationals or the mode of the former Soviet Union and East European countries featuring a fast distribution of the shares of their state-owned enterprises, China would have suffered a severe scene of imbalance in terms of wealth distribution, and would also have relinquished the power of dominating her national economy to foreign corporations or Chinese private oligarchs.

On the other hand, some people reckon that allowing foreign enterprises to share the stock equity of Chinese state-owned commercial banks equates to sale of state-owned assets at a discount. In actuality, had not strategic investors been ushered into China, Chinese state-owned commercial banks would not have improved their managerial skills so rapidly. Besides, had not the joint stock system been introduced and had not external individual directors been employed to ameliorate the enterprise governance structure, these state-owned enterprises would not have perambulated and made clear their relations with governmental administration authorities. Nowadays, governments at all levels have to undergo this institutionalized barrier before interfering with or imposing any fees on enterprises. This is the key to the success in the reform into state-owned enterprises.

The privatization-aimed reform in Russia and East European countries caused a breakup of the production link and a dramatic decrease of GNP. As a result, many a state-owned enterprises had their assets turn flimsy in value. By contrast in China, state-owned or state-controlled big enterprises, state-owned banks and medium and small enterprises which have been transformed into non-governmental players have seen their asset values skyrocket and their operating results much enhanced, which is another significant achievement on China's path of reform.

III. Stage of integration between society and market economy (2003-)

By 2003, China has achieved great results in her economic reform, and her national economy has kept growing at a fast pace (see Figure 3). In the same year, China was listed in the 6th place globally in terms of her economic aggregate, and a market economy system has been established by and large, as well.

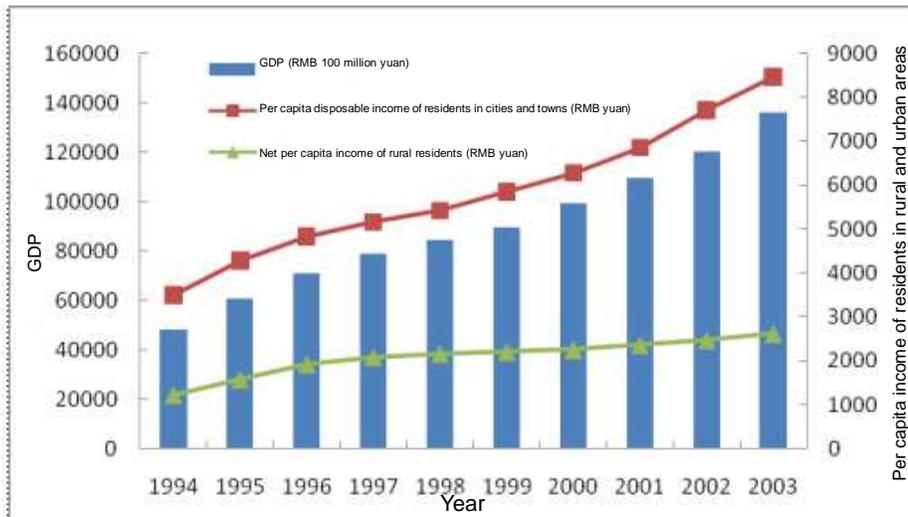


Figure 3: GDPs of China and incomes of residents in rural and urban areas from 1994 to 2003
(Data source: "China Statistical Yearbook 2007")

The reform in the 1990s was mainly targeted at urban economy. While boosting the economic growth,

the reform also resulted in a widening of the income gap. The gini coefficient, used to measure the income gap, rose to 0.45 in 2002 from 0.3 in 1978. The gap in terms of development between rural areas and urban areas and that among regions were further widened.

Meanwhile, in the preceding stage, the government had education, medical care and other public services provided by relevant players in the market, in order to alleviate its financial burdens and reduce its public expenses in these realms. The medical care and education expenses of rural and urban residents skyrocketed during the market-oriented reform, whilst the contributions made by the government in these regards fell down progressively, thus causing residents to spend a lot more in these regards. Education and medical care expenses have even become the biggest expense items of resident households in rural and urban areas. This not only affects the educational level and health conditions of residents, affects the human resources and impedes China from strengthening her competitive forces, but also jeopardizes the social equitableness, thus arresting much attention from the general public. In order to cope with possible risks in earnings, residents had to spend less and save more, which however impedes China from exploring her domestic market and increasing domestic demands.

In the year of 2003, when SARS burst out, the Chinese government put forward a concept of scientific development, and defined the development objective as to pursue socio-economic development in an all-sided, well-coordinated and sustainable manner and also to plan as a whole the developments of rural areas and urban areas, the developments of all regions as well as socio-economic development. Pursuant to this fresh strategic thought, the government focused its efforts in taking measures, in this stage, to integrate the society and market economy system. Main measures taken included (1) to conduct social reform and progressively a full social benefit system, expand its coverage and provide citizens with basic social security; (2) to implement regional development strategies in underdeveloped regions, develop China's west, reinvigorate China's northeast and help China's middle rise, so as to speed up the developments of economically lagging-behind regions and to shorten the gaps among regions in terms of development; (3) to accelerate the development of rural areas, alleviate the burdens of peasants, augment peasants' incomes, and foster sound morals with socialist features across rural areas; (4) to save energy and reduce emissions, and boost the economic development in a sustainable way. The objective of the reform is to establish a "harmonious society", and realize socio-economic development in a better coordinated and sustainable manner. Among others, the most important task is the social reform.

In this stage, the market economy system has been established by and large. The government took it as a focal task of the reform in the new stage to conduct social reform, and clearly announced to improve the social benefits system as to anti-poverty, education, employment, medical care, provision for the aged and housing, etc, in an aim to "enable the entire people to be educated compulsorily, paid for their labor, taken care of when ill, supported financially when aged and housed as well".

1. Construction of a new social benefits system

(1) Anti-poverty

With the economic growth, the size of China's rural population without sufficient food and clothing has decreased by leaps to over 23 million persons in 2006 from 260 million in 1978. However, with the growth of the laid-off and unemployed population size in urban areas, urban poverty became a fresh problem to be addressed in the new stage. To solve this problem, on 01 October 1999, the government set up a subsistence security system for urban residents across the country, covering a population size which rose to over 22 million persons in 2002 and remained on this level by and large. In 2007, the population size covered by such subsistence security system was 22.709 million persons.

For rural areas, in addition to the traditional policy of poverty alleviation through development, the Chinese government announced in 1996 that the focal task of the establishment of a social security system for rural areas was to set up a subsistence security system for rural areas, and stipulated the subsistence security funds for rural areas to be contributed by finance departments at all levels and respective villages. In 2007, the State Council announced to establish a rural subsistence security system across 31 provinces (autonomous regions and municipalities) of the country. In September 2008, the monthly actual expenditure out of the country's subsistence security funds for rural areas was RMB 2.02 billion yuan. On average, each rural resident received RMB 81.8 yuan as a subsistence security fund in a month.

(2) Education

As for basic education, China carried out a nine-year compulsory education system. Before the reform initialized in 1978, the educational costs of primary schools in rural areas were borne by villages. After the household responsibility system was put into force, as villages in most regions did not have any source of income, the costs of compulsory education in rural areas was actually borne by peasants themselves. This not only worsened the financial burdens of peasants, but also affected the supply of educational resources in rural areas and the balance of educational resources between rural areas and urban areas. In 2001, the government determined to reform and consummate the compulsory education system for rural areas, and have the costs of compulsory education shared by the central government and local governments, and alter the practice “collecting fees from peasants to finance the schooling” into that “educational costs are mostly paid by finance agencies, whilst the government pays the entirety of teachers’ salaries and expenses in public school construction”.

In 2003, the government made a clear decision to speed up the dissemination of compulsory education services across rural areas in China’s west, and provide the poverty-inflicted population of schooling age in rural areas with “two exemptions and one subsidy” (exemption from tuition fees and incidental fees, exemption from the costs of teaching materials, and subsidy for boarding expenses), as well as expanding the coverage of this arrangement onto the entirety of rural and urban students entitled to compulsory education in 2007. Local governments at all levels have also listed the compulsory education costs onto their public finance security programs as a whole.

(3) Employment

In the reform course, employment was ever a great impetus to boost the wheels of reform. From the late 1970s to the 1990s, in order to help a large number of youngsters in rural and urban areas get employed, the government had to ease its restrictions on non-public economy and make hard efforts in developing township enterprises to generate job openings. By the start of the 21st century, the country has progressively whipped into shape a consolidated labor market, promulgated such acts as the “Employment Promotion Act”, and adopted active employment policies to increase employment opportunities in the market.

As for unemployment security, in January 1999, the government promulgated the “Unemployment Insurance Regulations” and officially set up an unemployment insurance system for staff members and workers in cities and towns. In 2001, the government started to, step by step, have those laid-off employees out of state-owned enterprises covered by the unemployment insurance system instead of having them receive subsistence subsidies. By 2006, the transition from the subsistence security system to the unemployment insurance system for laid-off employees of state-owned enterprises has been completed as a whole, and the “three security lines” targeting laid-off and unemployed personnel gave its way to “two security lines”, namely the unemployment insurance system for insurant-role personnel and the subsistence security for low-income households in cities and towns.

In addition, the government also reinforced the “employment assistance system” targeting the unemployed population, and prioritized its provision of support and assistance to those personnel hardly able to seek jobs through such measures as tax cuts, interest discounted loans, social insurance subsidies, job-specific allowances and placement to public benefit positions, etc.

(4) Pension for the aged

Since 2003, the basic endowment insurance for rural and urban residents has gained an expanding coverage. The size of population covered by the basic endowment insurance system has increased to 151 million persons in 2007 from 116 million persons in 2003, thus constituting 51.6% of the total size of employed population in urban areas (see Figure 4).

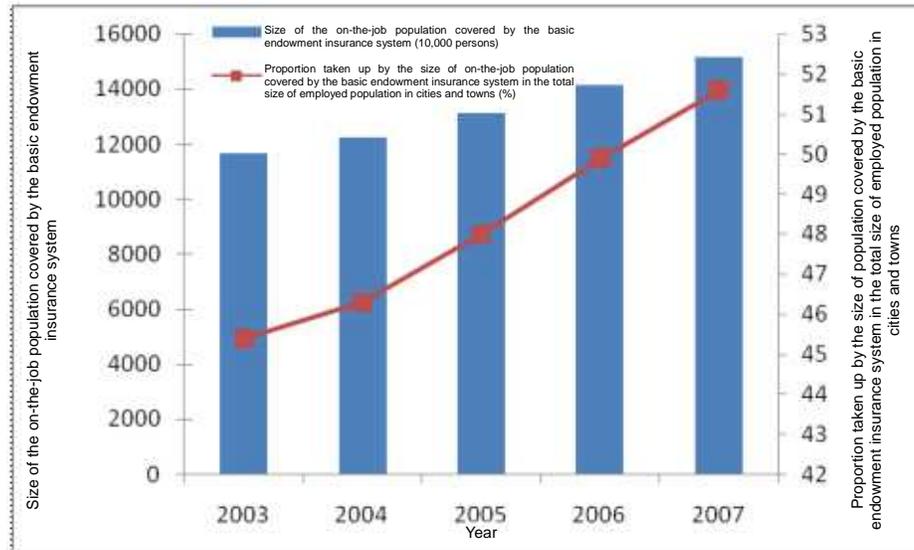


Figure 4: Size of the population in cities and towns covered by the basic endowment insurance system and coverage rate

Data source: National Bureau of Statistics of China, "China Statistical Yearbook 2007".

Traditionally, aged people in rural areas are supported mainly by their family members based on their outputs out of farmlands. Due to the childbirth control policy, the average size of rural family has been dwindling, an increasing number of members in rural families have left their homes for working elsewhere, and the rural population is getting aged accordingly. Thus, it has become increasingly imperative to implement a society-wide endowment insurance system for rural residents. In 1992, China began to implement this system in rural areas on a piloting basis. By the end of 2005, this system has been implemented in more than 1,900 pilot countries in the countries, covering up to more than 54 million persons. Economically better developed municipalities and provinces, such as Beijing, Jiangsu, Guangdong and Shandong, decided to grant larger amounts of subsidies to the implementation of the endowment insurance system in rural areas, so as to make the operating mode of the endowment insurance system for rural areas feature a "combination between individual accounts and subsidy adjustments" instead of being "wholly based on individual accounts".

Besides, the government will also expand the old-age security funds to cover two specific kinds of people, namely those hailing from rural families entitled to five assurances (as to food, clothing, housing, medical care and funeral) and those from rural families each with only one child or each with two female children. Such practice has been carried out on a piloting basis since 2005 and spread across the country since 2007. It has provided stable basic security for those families each with only one child in the society where the aged population is gaining a growing size.

(5) Medical care

Since the reform into the economic system, the volume of medical care resources in China has grown rapidly, whilst the numbers of medical institutions, specialists, equipment items and medicines have all increased speedily. In the meantime, medical costs have been increased at a growing pace. Due to the government's decreasing contributions, patients had to pay a majority of their medical costs on their own. In 2003, China saw the proportion taken up by her public health expenditure in her total health care expenditure stay at 36.2% only, thus ranking herself in the fourth-last in 199 countries surveyed by WHO.

As the people's well-being arrests more and more heed, and in particular the SARS crisis in 2003 revealed the loopholes existing in the public health system and the medical service system for rural and urban areas, the government has increased its input in the realm of public health by leaps. Since 2004, the government has also started to reconstruct and consummate the medical security system for rural and urban residents. In urban regions, employees in cities and towns and the unemployed population are all covered by the "basic medical insurance system for staff members and workers" and the "basic medical insurance system for residents in rural and urban areas". In rural areas, a fresh rural

cooperative medical care system was set up to cover the rural population. In addition, the Chinese government also set up a medical aid system for the poverty-inflicted population in rural areas and urban areas step by step, so as to assist the poverty-inflicted population in receiving medical aid.

(6) Housing

Under the planned economic system, urbanites were allocated public housing properties in kind. At that time, housing properties were allocated by employers as a type of welfare to their staff members and workers. As the reform into economic system was carried into depth, the imperfections of this system, such as poor applicability, low efficiency and unsatisfactory equality, have loomed increasingly large. In 1998, the Chinese government initialized a reform into the housing system characterized by the abolishment of welfare-oriented allocation of housing properties, and the housing market has kept expanding constantly thereafter. Averagely, each of the past few years since 2000 saw the total area of housing properties newly erected in urban and rural areas reach 1.3 billion square meters, whilst the per capita housing area of urban and rural residents has also increased by leaps.

However, lands are state-owned and the government has monopolized the primary market of land transaction, and taken control of land assignments and transfers to garner a huge amount of proceeds, which become important sources of financial revenues earned by local governments. Therefore, local governments have kept enhancing the land assignment/transfer prices in order to augment their revenues as such. Consequently, prices of commodity housing properties have kept increasing, causing most families which earn medium or low incomes and thus are hardly able to purchase housing properties to become unable to address their housing needs by their own means. The government's insufficient efforts in offering housing assurance has made it hard for certain groups of people to solve their housing difficulties, which has turned out an eye-catching social problem.

In 1999, the government announced to set up a framework for its low-rental housing policy for urban areas, but made slow progress in this regard. In 2003, the central government announced to reinforce the government's function in assuring housing supplies and provide low-income households with low-rental housing properties. By the end of 2006, 512 cities in China have each set up and implemented a low-rental housing system, and 547,000 low-income households in total have ameliorated their housing conditions thanks to the low-rental housing system. On top of that, for those households not being able to address their housing needs by their own means, the government also put into force such housing aid policies as the "affordable housing system" and "limited-price commodity housing policy"¹¹.

2. Alleviation of peasants' burdens, increase of peasants' incomes and construction of sound morals in rural areas with socialist characteristics

From the early implementation of the policy of reform and opening up to the start of the 21st century, the government has levied an increasing amount of charges, under various titles, on peasants. As per statistics, the total amount of taxes levied on peasants rose to RMB 135.9 billion yuan in 2000 from RMB 46.9 billion in 1990; in the same period of time, the per capita amount of taxes levied on peasants rose to RMB 16.84 yuan from RMB 5.58 yuan, recording a growth rate in excess of that of peasants' income in the same period of time (Su Ming, 2008). In the context of a constantly widening income gap between urban areas and rural areas, excessive burdens on peasants also affected the social stability, and caused the relations between grassroots governments in charge of levying taxes and peasants to deteriorate, as well as giving rise to flaring contradictions between the two sides.

In order to mitigate peasants' burden, better the relations between grassroots and the general public, and maintain the social stability in rural areas, the Chinese government started in 2000 to call off and adjust the taxes levied on peasants in pilot areas. In 2005, China abolished, across her territory, agricultural taxes which have been levied throughout over 2,000 years in the past, thus alleviating the burdens on peasants by leaps. The financial authorities of the central government resorted to transfer

11 The affordable housing system means a system under which the government erects housing properties according to certain standards and sets down favorable prices for these properties towards low-income families in urban areas which suffer housing difficulties so as to have their housing needs met. The limited-price commercial housing policy means a policy under which the government conducts supervision and market-oriented operations, and sets restrictions on the partitioning options and prices of housing properties as early as in the stage of land supplying, before supplying these housing properties to medium and low income residents in cities and towns. These systems both function by means of the government's favorable policies in an aim to bring down the prices of housing properties and to enable medium and low income earners to buy housing properties.

payment to solve those problems thus incurred, including the decrease of financial revenues of grassroots governments.

In the course of establishing various welfare systems, the government also incorporated peasants into its programs, by means of developing the compulsory education cause, medical care, old-age provision and subsistence security in rural areas, etc. However, with the country's readjustment of its industrial layout, an increasing number of rural residents have swarmed into cities for employment, causing the size of resident population in rural areas and engaged in farming to fall along the way and consequently affecting the farming output. Meanwhile, the gaps between rural areas and urban areas have widened in terms of not only income amount, but also public service skills. To address these problems, the Chinese government started in 2005 to advocate the construction of new socialist morals in rural areas, mobilize urban areas to support rural areas, and enable industrial players help agricultural players development, in an aim to coordinate the developments of rural areas and urban areas.

The objective of constructing new morals in rural areas has been summarized as "growth of production, financial steadiness, due civilization, tidy living environment and managerial democracy". Major measures adopted have included: greater investments in construction of infrastructure facilities in rural areas, acceleration in developing the education, health care and social securities causes in rural areas, more subsidies to agricultural production, and boosting of agricultural production. After these measures were taken, China saw her output of cereal crops grow steadfastly. Meanwhile, infrastructure facilities in rural areas have been improved evidently, and peasants have earned palpably more incomes than ever.

3. Discussion: reform into the social system – What kind of a market economy system shall China build up?

For those people advocating The Washington Consensus, there is only one kind of market economy, which is liberal economy based on private property. However, compared to the vivid and enriched reality, it is nothing more than a simple abstraction in economics. Different market economy systems came into shape in consequence of a combination between the world's diverse arrangements for market economy system and the world's all-different social welfare systems.

The Chinese government defined the objective of its reform as to establish a "socialist market economy system", which has to not only allocate resources in the principle of efficiency enhancement, but also distribute incomes and offer social security for the purpose of social equality. At the start of this century, when the then China has, by and large, established her market economy system and also attained her goal of establishing an affluent society as a whole, the Chinese government timely put forward the development objective of "constructing an affluent society in an all-sided way" with such traits as "letting the entire people share the affluent society" and "making progress in an all-sided way" (Wang Mengkui, 2003).

An important element of China's reform into her social system is the construction of a social welfare system, which refers to: 1) transforming the welfare arrangements made under the previous planned economy system on the basis of affiliations to "work units" into arrangements for the social system on the basis of market economy; 2) expanding the social security which was formerly applicable only to the state-owned economy sector in urban areas to rural areas, and realizing a society-wide coverage. Considering the current position occupied by China among other medium and low income developing countries and also having regard to her huge population size, the ongoing trial of China is of great significance.

During the transition to the market economy system, the government has gradually withdrawn itself from the complicated, sundry matters as to direct control of prices and direct management over enterprises, unleashed the powers of management over these enterprises, devolved some of its powers. This is not a hard task, relatively speaking. Although corruption occurred also in this course, no influence was caused on this course, by and large.

Construction of a social welfare system not only means that the government's responsibilities to the society are expanded to cover more fields, but also signals that the government has to directly manage a lot more financial resources. If corruption becomes a prevailing scene, uneasiness and discontentment are prone to be triggered off on the part of the general public, who will feel their interests jeopardized. This will be a great challenge against the Chinese government's governance abilities.

IV. Conclusion: China's basic experience of reform

Through a comparison among China and the former Soviet Union and East European countries, we have seen the differences among their reform policies. The former Soviet Union and East European countries adopted a "shock therapy", which was based on The Washington Consensus and featured a trinity among "liberalization, stabilization and privatization". In contrast, China employed a dual system, and the policy of "intensifying the management over big players and unleashing the powers of management over small ones" as well as the policy of constructing a social welfare system beneficial to the entire people. These two options both managed to set up a market economy system. However, the reform course of China differed largely from those of the former Soviet Union and East European countries. The differences were manifested on the fronts of equity structure, macro-economic regulation mode and social welfare system. More importantly, they paid different prices in economic and social terms, and thus gained different socio-economic development results. China's reform is a great social reform in the humankind's history and way far from its ending. But the experience learned throughout this reform is worth summarizing conscientiously.

1. Political stability is a condition precedent for the success of reform

Reform is self-consummation of the socio-economic system under the leadership of the party in power. It requires the party in power to have the willingness and also the ability to stand in the front to lead the revolution. The Communist Party of China cherishes a firm belief in and makes an unswerving commitment to the reinvigoration of the Chinese nation, progress of the Chinese society and pursuit of affluence for the Chinese people, and also maintains a clear awareness and vigilance of its position in the realm of international competitions and of its responsibilities, together with a strong sense of mission. The Communist Party of China is a leader of reform, and has experienced this reform by itself, as well. Therefore, in the past 3 decades, it has succeeded in guiding this reform. Under the leadership of the Communist Party of China, China has maintained its political stability, thus enabling her to accomplish the readjustment of various social interests and reform into various systems throughout the course of reform, without causing any severe social conflicts and contradictions. Political stability has enabled the government to effect protection of property rights and various rights and interests in relevancy thus making it probable for the market-led mechanism to function properly.

The "The Washington Consensus" stresses the necessity of radically smashing the state organs in socialist countries existing in today's world, and creating a "primitive state", so as to establish new systems on ashes. However in reality, such belief sabotages the macro conditions for economic operations, and results in a loss of authority when it comes to redistributing properties. Therefore, economic recession and inequality in terms of property distribution are inevitable results of such belief.

2. The people are the propellers and beneficiaries of the reform

The purpose of all these efforts made by the Communist Party of China is to persistently improve the living conditions of the people and let them live an affluent life. Therefore, the reform has witnessed an unswerving persistence in taking it as a major indicator, by which to judge whether the reform is successful or not, to see if the national economy has ever grown and whether the people have benefited therefrom. Reform, development, enhancement of the people's living standards and political stability have constituted a benign cycle. Meanwhile, China's reform laid a greater emphasis on experimenting and institutional creation by the people under the leadership of the government, and also on giving full play to and mobilizing the initiatives and go-aheadism of the masses, so as to enable the progressive reform to carry itself forward ceaselessly.

However, the "The Washington Consensus" are of the belief that a handful of educated elites can formulate programs and enact laws, in lieu of the people's accomplishment of reform. In actuality, the people have to pay a price of seeing their living standards lower down and even having their life expectancies shortened.

3. The ownership system is established and improved step by step.

As early as shortly after initializing the reform, the Chinese government has realized that property rights can be decomposed, and that peasants would demonstrate great initiatives in increasing their production outputs once the right to use of lands and the right to derive benefits from lands are made clear. The same case also arises in the reform into township enterprises, collectively owned enterprises in urban areas and state-owned enterprises. Therefore, it is advised to get started from the right to use and the right to derive benefits, and it won't be necessary to urgently reform the ownership system thoroughly until the national economy has reached a stage wherein it is required to make clear

the long-term right to derive benefits and the right to dispose of properties (such as the cases of succession and assignment). Therefore, as to the reform into the ownership system, China may follow a "step by step" option. This also explains why China has not become able to, and it has not become necessary for China to, lay down a relatively well-devised "real right law" until 20 years after the country has initialized the reform.

The "swift privatization" advocated by the "The Washington Consensus" can hardly be said to have any proven evidence whatsoever to stand on. As a matter of fact, advocators of such common understandings have based their considerations on the basis of "making conditions irreversible", which does not have any footing in theoretical terms, either.

4. Competition is the momentum propelling the economic growth

Another doctrine confirmed by the Chinese government at the early stage of its reform is that competition is the momentum propelling the economic growth. Therefore, China has paid heed to boost and maintain competitions. In practice, the country has opened its market to not only domestic players, but also overseas players from afar, so as to foster an international competition scene. Some foreign economists ever demonstrated that competition, instead of private property rights, is the characteristic and condition precedent of market economy (Perkins, 1986). The crucial deficiency for socialist economy is not the lack of private property rights, but the lack of competition, incentives and decentralization (Stiglitz, 1994). The progressive reform carried on by the Chinese government, and China's uninterrupted development of her non-public economy sector and her dual system applied in the course of pricing reform have all created conditions necessary for fostering market competitors. In regard to the reform into enterprises, particularly as for medium and big sized state-owned enterprises, the government has never regarded as their privatization as the ultimate solution, but instead taken it as a focal task to break down the monopoly scene in many an industry and also to encourage competitions, thus having facilitating the developments of state-owned enterprises.

Contrarily, the "The Washington Consensus" emphasize property rights, but ignore the fight against monopoly, while stressing swift privatization but paying little heed to foster the institutional foundation for market competitions. The re-distribution of the existing assets can not serve as a guarantee for economic growth. Instead, market competitions generate the very momentum for the growth of national economy.

5. Partial reform is possible

China initialized her reform in certain parts of her territory, before integrating the rest of her homeland to experience the reform. Such a progressive mode of reform effectively reduces the risks of reform and ensures the reform to be carried into growing depth. China has a vast land and a huge population. There exist huge differences among different parts of China, and also between urban areas and rural areas. All these are the conditions that show China's progressive reform can be initialized from pilot areas. Practices have shown that it is a wise option to "cross the river by feeling about the stones under feet", conduct experiments from time to time and pursue innovations, sum up experience and learn from lessons. This is a duly feasible decision-making method for such a developing country like China which lacks managerial experience as to market economy and suffers a shortage of managerial talent.

Different countries in the world have all different conditions. Thus their reforms and development paths have demonstrated significance variances. There never exists a so-called "standard path". China does not reckon that her own experience is surely applicable in other countries. However, the success of China's reform indicates that China has made the right choice of effecting her economic reform and pursuing modernization in view of her specific national conditions. On the contrary, those advocators of the "The Washington Consensus" have little regard to historical, cultural, economic and political conditions, and try to transplant a system devised by themselves into those countries undergoing a transformation, which is ostensibly infeasible.

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