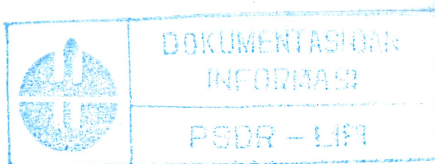


**THE IMPACT OF MARKET ECONOMY
ON THE DEVELOPMENT OF COMMUNISM:
A Study of Economic Reform in the Republic of China
(1978–2003)**

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**THE IMPACT OF MARKET ECONOMY TO THE DEVELOPMENT OF
COMMUNISM: A STUDY OF ECONOMY REFORMATION
IN THE REPUBLIC OF CHINA 1978-12003**

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PREFACE

The Impact of the Market Economy on The Development of Communism: A Study of Economic Reform in the Republic of China (1978 – 2003) was the first research project that was carried out in China by the Research Center for Regional Resources, the Indonesian Institute of Sciences (PSDR LIPI), in 2005. This study of the Chinese economy and its impact will be carried out over three years and we are pleased with this first year's research carried out by four people with backgrounds in economics, sociology, politics, and anthropology.

In this study we try to explain the background of economic reform, the format of the PRC economic policy, and the development of the Chinese economy at present and in the future. It is important to know about the development of the PRC economy as a result of the reform processes and its future prospects. The purpose of this study is to explain the factors that put the PRC one step ahead in competition and made it an Asian economic superpower.

The development of the Chinese economy, as a result of the economic reform policies from 1978 to 2003, has made a great contribution to the modernization of the country, both in agriculture and in industry and brought China one step ahead in the global economy. Many social and political conditions affected Chinese reforms but China successfully coped with them through economic policies pioneered by Deng Xiaoping in 1978.

Many thanks are due to our colleagues in China who have given us great assistance in completing this research. Firstly, thank you very much to the Indonesian Embassy in China, Mr Djudjur S.H. the Indonesian Ambassador, Mr Hutagalung the Counsellor for Information, Social, and Cultural Affairs for his great help to the research team, Mr Andriana Supandy Minister-Counsellor and his assistants for helping the team with Chinese data and Mr Riyono and Mr Hadi Hidayat, Senior Officials of the Indonesian Embassy for their assistance in accompanying and otherwise helping the team.

Secondly, to our colleagues in the academic sphere, Dr Wendy Chan of the Institute of Economics, Xiamen University, for her assistance in issuing the invitation letter and information to the team. Professor Minhe Liang, the Dean of the Faculty of Oriental Languages and Culture, School of Foreign Languages, Beijing University for his great help in assisting with information and networking. Professor Zhou Nanjing, the Deputy Chairman of the China Society of Overseas Chinese Historical Studies, Director of the Center for Chinese Overseas Studies, Beijing University and the Professor of the Academy of International Relations, Beijing University for his very friendly and useful interview. Mr Harto and Mr Darma (their Indonesian names) students in the Masters' Program in the School of Foreign Languages, Beijing University, for helping and accompanying the team. Mr Ji Ping the Director of the International Department of the Central Committee of the Communist Party of China for his assistance, data, and information and Dr Natalia Soebadjo a Lecturer in Chinese Studies, University of Indonesia, who was doing research in Shanghai, China; for her assistance and information when the team members were in China.

Many thanks also to our colleagues in PSDR and IPSK LIPI for their criticism and suggestions. As well, we want to extend our gratitude to our administrative staff for their assistance and cooperation. This report has already gone through some revision and discussion as well as seminars, held by PSDR LIPI, however, we are looking forward to receiving further input and suggestions.

Jakarta, 12 December, 2005

Director

Research Center for Regional Resources

Indonesian Institute of Sciences

Dr. Yekti Maunati,

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CHAPTER I

INTRODUCTION

By Cahyo Pamungkas and Erlita Tantri

I.1. The Background

Economic reform is one of the remarkable stages in the historical development of the People's Republic of China (PRC). Before the reform, PRC was known as a communist country using the autarchy development strategy that came from the principle of self-sufficiency.¹ This development model, which was introduced by Mao Zedong, is also known as socialist revolutionary development model. One of the characteristics of this model is that the development of agricultural sector is on the top position². Based on Mao's perspective, the modern socialist society should be attained through the process of transformation, which occurred in the rural area³. As a result, agricultural development, which is based in the rural area, became a precondition of the development of PRC in 1949-1978 period.

Mao constructed the logic, which is basically postulates that the capital from agricultural sector cannot be taken from rural areas to supply the development of industrial sector in urban areas. Those capitals had to remain in the rural communities to emend nutrient, health, social service, and education procurement for the farmers. Agricultural development was given more priority than heavy industrial development to increase the accumulation of social capital. Every pressure toward heavy-industry sector will adversely affect the development of agricultural sector. This policy was conducted by developing a large agricultural venture system of as much as 500-1000 ha for every production unit. Moreover, the land reform policy was also conducted to bypass

¹ See Poltak Partogi Nainggolan, 1995, Reformasi Ekonomi RRC era Deng Xiaoping, p. 17.

² Nainggolan, p. 54

³ Ibid.

the relation between feudalism and capitalism production as an inheritance from the old structure⁴.

After the year of 1955, the PRC's government changed its development strategy with strategy with the Great Leap Forward policy: to attain high economic growth by giving pressure at industrial sector development, Liu Sao Xi and Deng Xiaoping pioneered this development model, which was conducted by a central planning system; controlled by the bureaucrats to coordinate the work and shift responsibility in a rational way⁵. Mao allowed this model to operate considering that this system had already run in the Soviet Union. Mao believed that the society did not have to depend on the development of production power first to attain the socialism and communism phase. Though the socialist production mode had already been reached, it did not mean that the socialist social relations were automatically attained.

This policy was conducted by forming people's communes in rural areas. These communes were designed to make the transition from socialism to communism possible. However, this policy showed a different result from that expected by Mao⁶. The revenue from agricultural and industrial sector lessened. The people's commune did not show productivity escalation and the private and individual ventures were forbidden by the state. In this situation, agricultural production per work denomination unit lessened. Four years after the Great Leap Forward policy, there was a famine that caused the death of 30 million people (1958-1960).

Liu Sao Xi, who had replaced Mao as the chairman of the communist party and thus the de facto head of the country, reapplied the socialist development system and enlarged the Great Leap Forward program. Intensive material use was allowed to increase citizen's work-productivity. Expert, technicians, and intellectuals were acknowledged in contributing ideas and got their

⁴ Nainggolan, p. 56

⁵ Nainggolan, page 64

⁶ Nainggolan, page 75

position back in the society. Mao himself contended that the convictions of people ideology and prestige had to be emended to prevent the death of revolutionary spirit and the reappearance of capitalism as an impact of recovery program after the Great Leap Forward program⁷. This period (1966-1976) was known as a Cultural Revolution era during which the application of the development model was based on political mobilization instead of on technocratic principles. The revolutionary committees, considered as a new class, replaced the bureaucrats, technocrats, and intellectuals in the society. This policy led to the getting rid of 250,000-500,000 people thought to be capitalists.⁸

Cultural Revolution affected the lessening of production sector in 1967, which only recovered in 1969. During 1966-1976 period, there was chaos everywhere. Schools and factories were closed; and there were life decadences of Chinese society. Mao's development strategy gave a higher level of even-distribution than that of developing countries. However, the social cost was too much, proved by the abundance of human victims. After Mao and Zhou Enlai died in 1976, their inheritors, Deng Xiaoping and Hua Guofeng conducted the modernization by accepting four principles; the People's Republic of China is still a socialist country, People's democratic is paramount, the Supremacy of Chinese Communist Party (CPC), and Maoism as state ideology⁹. Afterwards, Deng Xiaoping consolidated his supporters to conduct a set of economic reform programs.

Economic reform of the People's Republic of China was possible because of the support of many factors, both internal and external that interrelated one with another¹⁰:

1. The conversion of leadership structure in the PRC after Mao Zedong era had an effect on the on the greater power of reformist group under the direction of Deng Xiaoping.

⁷ Nainggolan, page 79

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid.

2. The Mao Zedong development strategies, which were radical and precedent political development, caused a lot of sacrifice and regression.
3. The choice to prioritize economic development to increase welfare standard of the society.
4. The development of global politics that shows the more dangerous threats from the superpower countries and the PRC's prime enemy.

Economic reform policy was begun when Deng Xiaoping held power from 1978 through the third session of the 11th National Congress of Communist Party of China¹¹. This policy involved the re-conjugating communism theory to give a new direction to the economic policy and to the government of PRC in the future. The basic essence of socialism theory, based on Deng Xiaoping's thinking, was to be in the freedom and the development of productive power (Al Mandari, 2003). Next, it was said that the failure or success criteria of a party should be returned to the people, whether they were satisfied or dissatisfied or liked or disliked the party. The economic program was considered to have a role in deciding people's endorsement of both the CPC and the PRC.

PRC began to apply the economic reform that was based on market economy but also kept the socialist theory and doctrine. Classic Marxism with socialist governance system foundation was still actuated in agreement with the conversion to the capitalistic economic system. What happened next was that a mutual-espousal relation between political stability as a product of communist governance system and economic growth as a product of the market economic system was constructed. At a certain level, market economy was not at odds with authoritarian governance system because there was a guarantee of the governance and security stability over a long-term period. Indonesian and South Korean experiences before entering democracy eras showed that authoritarian system was compatible with market economy.

¹¹ Ibid.

Development plan using the market economy was divided into three stages over a 24-year: the Initiating stage (1978-1984), the Exploring stage (1984-1991), and the Standardizing stage (1992-now). Before the economic reform programs were implemented, almost all enterprises in PRC belonged to all the societies that formed state enterprises. In this period, there were several enterprises collectively owned by the society, but the management was similar to that of the state enterprises. This was comprehensible since the economic system conducted before the reform era was a planned economic system.

In this economic system, state enterprises did not emphasize their function in gaining the benefit and were not managed independently by the directors or the owners. People who had a role in enterprise's decision and policy making were the CPC and PRC government, so the enterprises were only functioning as production units. Those enterprises only ran the production while the government decided their products and prices. The government also conducted the selling and receiving function and decided benefit distribution of the enterprises. As a result, the enterprises became dependent and underwent quite low product inefficiency.

This new system was publicly known as market economic system where the production applications, such as enterprises, belonged to certain class in the society. Those enterprises not only functioned as technical production units, but also had the autonomy to plan, conduct, and sell their products. The goal of the enterprise was to get benefit, that also became the motive in the production process. Besides, enterprises had the authority to decide the benefit distribution to workers and managers, to give production bonus, to hire/fire the workers, etc. These authorities were enacted by The State Council in May 1984 that gave autonomy to state enterprises in 10 areas: production and operation; programming; product sales; pricing; material procurement; use of

funds; disposition of property; structuring; personnel and labor; distribution of wages and bonuses; and the utilization of a combination of power.¹²

In 1984, the CPC 12th congress decided the economic reform policy known as “the whole people, collectives and individuals to go all out”. This policy encouraged all the economic sectors whether they belonged to individuals or societies or even foreign enterprises to incorporate in building contractual/equity joint ventures or associations. Thus, state enterprises were allowed to exist or to merge with individual or public enterprises. The CPC 13th congress in 1987 proposed the mergers of small-scale state enterprises share system with the public enterprises. The government also defined the Enterprise Law 1988 that regulated state enterprises. In addition, the government developed the policy regulation to protect private enterprises: Interim Regulation for the administration of Urban and Rural Individual Industrial and commercial Businesses, the Law of Foreign Invested Enterprises, and the Provisional Regulations of Private Enterprise.

The 12th CPC congress also ascertained development reform from the rural area to urban area and state enterprises reform as the centre of national reform program. During 1984-1991, growth average of state enterprise output sum per year gained 8.3%, meanwhile the private enterprises gained 23.9%, and the public enterprises gained 19.7%. Whereas, growth average of individual enterprises output in urban and rural area per year was in the amounted to 45.4% and the growth of industrial sector amounted to 47.3%. In 1991, non-state enterprise output made a 43.8% contribution to the total production. These proved that the efficiency level of private enterprises was higher than that of the state enterprises still under government administration.

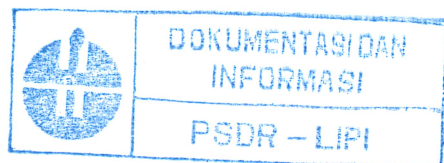
In 1992, when the economic reform in PRC reached the standardization stage, the State Council brought out policies such as Rules for Shifting the Operational Mechanism of the Industrial Enterprises Owned by the Whole

¹² Ibid.

People, that could give a wider authority to the state enterprises. There were at least 14 rights of state enterprises: decision-making in production and operation; price-setting for products and labor; selling of products; material purchase; import and export; investment decision; disposition of retained bonuses; dispositions of property; decision on joint operation or mergers; labor employment; personnel management; distribution of wages and bonuses; internal structuring; and refusing apportioning. As the result, state enterprises were treated just like public enterprises, which assured profit and loss regardless of government's subsidies.

To complete the on-going economic system as an umbrella for the whole development processes and economic reform programs, the CPC congress ascertained the establishment of a socialist market economic system. The system basically emphasized that market had a fundamental role related to the regulation of economic resources under the state control sector. The state created some conditions so that all economic sectors could participate in the competitive free market based on equal opportunity. As the consequence, all enterprises should be treated equally with no discrimination against any group of certain enterprises. In December 1993, the Company Law was ratified. It stated that the enterprises funded by different investment corporation were treated equally in law. The 15th CPC congress in 1997 ascertained that private enterprises were important components in socialist market economic system. The 1999 constitution amendment proclaimed that the status and the role of private enterprises were important in PRC economy structure.

In September 1999, the CPC Congress also revealed several important issues related to the transformation and development of state enterprises in turning themselves into a modern enterprise system. One of the issues was the diversification of share ownership that involved foreign investment corporations. Next, in April 2001, The State Commerce and Economic Commission and Labour/Social Assurance Minister ascertained the Opinions on Deepening the Reforms of the Internal Personnel, Labour and Distribution systems of State enterprises. Those rules stated that the enterprise administration stage



was cancelled; enterprise directors were no longer officially responsible to the government administration. The directors of enterprises could be elected by the shareholders or by open election and could be recruited from all factions in the society.

In 1994, there were 33,000 joint venture enterprises in the People's Republic of China (PRC). The government privatized 100 state enterprises in November 1994. The state enterprises were able to develop into independent entities in market mechanisms and became independent. The enterprises consisted of shareholder assembly, director council, commissary council, and managerial staff. Each had a different job and authority in policymaking, policy implementation, supervision, and policy execution. From 1991 to 2001, the growth average level of public and state merger enterprises gained 17.3%; public enterprise output gained 24.3%. In 2001, public enterprise output gained 78.3% from the total industry while in 1991 it had gained 45.8%.

Those policies were supported by the people of China and were acknowledged as the continuation of the historical process that was initiated by the Chinese revolution and reconstruction process. The result of Deng Xiaoping's reform program can be seen mainly in two issues; the social market economic system and the liberalization of ideas. The social market economic system was basically a system that regulated based on a free market mechanism, but it was directed by the government to assure equity for all people. The liberalization of ideas was more intended to make the spirit of hard work become a tradition in a developing economy as postulated by Max Weber.

The economic reforms of the PRC had some effect on its economic growth and strengthened the position of the PRC in the global economic structure. The PRC has grown into a country with an average 7-8% economic growth over the last ten years. This quite significant progress was also followed by the ability to attract investment and encouraged the PRC to become one of the centres of the global economy. In 2000, the PRC economic growth rose to 8% with 27.9% for exports and 35.8% for imports (Sutarjo 2003). In 2001 when

many countries experienced decreasing economic growth, the PRC economy was still able to grow by 7.3% with 6.8% for exports and 8.2% for imports. This placed the PRC in the 9th position in the world economy (Sutarjo 2003).

The success of the PRC reform program was supported by several factors (Sutarjo 2003). First, it was conducted carefully, in phases, pragmatically, and patiently. The reform course was first settled so that it could become a framework for the implementation of policy. Second, the success of the program was also followed by other reforms in the governance, culture, and law. The development in governance was directed into the creation of national stability to support economic development. Law development was directed to the creation of law enforcement that could bring justice to the people.

The economic reforms not only changed the reform area but also affected socio cultural and governance changes. This was in accordance with Todaro (1990) who states that economic development is not only oriented to economic development but also covers the changes of the socio culture and institutions of the society. Karl Marx (1848) gave a more critical opinion that the application of a market economy system in a society would divide it into two main classes, the asset owners who own production devices and the labourers who do not have the production devices (Laeyendecker 1993).

The classic Marxist theory is mainly a basic theory about the competition between the communist social system and governance. Based on this theory, societies applying the market economy to industry are divided into two contradictive classes: the business class who own production devices and the labouring class who do not (Laeyendecker 1993). This disagreement is caused by the imbalance of income distribution that is getting bigger and bigger: the businessmen who try to be as wealthy as possible and the workers that live in poverty.

The conflict would be won by labour and change the social system to be communist. This system was a social structure in which all the production devices were managed by the labouring class whose members instituted them-

selves in a sole communist party (Mills 2003: 62). Thus, in a communist country, the business classes were not allowed to exist since they were enemies of the social system and were the source of the imbalance in the society. The social classes avowed publicly in a communist country (the People's Republic of China) were workers and farmers. Those two classes were the main pillars of the communist governance system.

However, the application of the market economy in the People's Republic of China since 1978 has had an effect in forming a new class in the society; the business class. Before Deng Xiaoping applied the economic reform policy, the business class was forbidden to live and to grow in the communist governance system. But after the application of the market economy, the existence of the business class became a need to enforce national economic development. This class was naturally formed in compliance with the government program and policy to give opportunity to the society to develop certain economic sectors. Meanwhile the state was more concerned to handle strategic economic sectors that important to the existence of the national economy.

The development of the business class was a rational consequence of the existence of the market economy policy. Tsai (2002: 316) reveals that from 1978 to 2002 the growth of public enterprises in the PRC reached 20% per year. Recently, there have been estimated to be about 30 million private enterprises that make a significant contribution to government taxes and hire millions of workers that were previously fired from the state owned enterprises, and also contribute about 2/3 to the GDP. Those were supported by financial sources for private sector investment in the PRC with a higher and higher proportion to the GDP from about 12.7% (1990) to 87.7% (2001) (WDR 2003).

The business class here did not cover the entrepreneur classification or small and middle class businesspeople but was more like Fernand Braudel's classification that divides the economic system into three: the subsistence economy, the market economy, and capitalism (Kunio 1990). Capitalism is

an economic activity performed by the market using a huge asset and operational scale (Kunio 1990). Thus, businessmen are individual enterprise owners or venture shareholders of big enterprises. They include independent businessmen or bureaucrats, military officials, CPC officials, and their cronies who own the enterprises. On the other hand, lower level businessmen whose influence was based on kinship were also making an important contribution to force economic liberalization (King and Ashley 2003). In addition, the categorization of businessmen also covers large entrepreneurs who have dual citizenship; of the PRC and another country, but invest their assets in significant amounts in the PRC.

If we look at the contribution of national investment, most of the investments (60%) were made by state owned enterprises where the government spent 30% of the state enterprise budget. While the rest of the investments (40%) were made by private entrepreneurs funded from society's account (John D. Lang Lois 2000). However, among those private enterprises there were 15,000-20,000 army owned enterprises subsidized by the government. They endeavoured in many areas such as hospitals, animal husbandry, pharmacies, airways, hotels, textiles, real estate, etc. The abundance of those kinds of enterprises created an assumption that these large entrepreneurs were coming from among the powerful bureaucrats or the CPC elite class and their cronies.

Related to the reforms in the People's Republic of China, William Overholdt (1994) explained the differences of approach and reform strategies applied by the PRC and the Soviet Union. The PRC preferred taking the example of reform and economic development that had been successful previously in neighbouring countries such as in South Korea, rather than from other communist countries. The PRC, along with South Korea, Taiwan, Hong Kong, and Singapore has become a role model for the economic development of Asian countries. The development model in the Soviet Union ignored the reforms in the agricultural sectors because the Soviet Union relied on heavy industry, so it could not attract foreign investment. Meanwhile, the PRC gave priority to agricultural as well as industrial development, so that it was able to

encourage fast economic growth. The PRC boosted productivity escalation in the agricultural sector by returning agricultural land to the farmers. Besides, a program to attract foreign investment and to push small industry development has become a part of the reform policy.

Those differences of development strategy yielded significant output differences in a six-year reform period. The People's Republic of China showed greater and greater GNP growth from 1980 to 1986 from 7.8% to 12.7%, while the Soviet Union had a decrease from 2.6% to -18.2% in the same period. The complete picture can be seen in the following Table:

Table 1.1

The People's Republic of China and the Soviet Union GNP's Growth
In the First Six Year of Reform (in percentages)

No.	Year	The People's Republic Of China	Year	The Soviet Union
1.	1980	7.8	1986	2.6
2.	1981	4.5	1987	1.7
3.	1982	8.7	1988	4.1
4.	1983	10.3	1989	-2
5.	1984	14.6	1990	-6
6.	1985	12.7	1991	-18.2

Source: China Statistical Year Book 2004

As previously explained, this study tries to explain the format of the PRC economic policy, and what factors influenced that economic reform. In addition, it is also important to know the development of the PRC economy as the result of those reform processes and the prospects for this economy. The results of this study are expected to be able to explain the factors that put the People's Republic of China one step ahead in competitiveness and also an economic superpower.

I.2. The Problems

The questions expected to be answered in this study are:

1. What kind of economic reform policies were applied by the People's Republic of China government?
2. What factors stimulated the government of the People's Republic of China to enact those policy?
3. What shape is the economic development of the People's Republic of China after the application of those policy?
4. What is the economy prospect of the People's Republic of China's economy in the relation to the globalizations of world economy?

I.3. Research Aims

III.1. General Aim

The general aim of this research is to map the problems related to the economic reform policies in the People's Republic of China from 1978 until now.

III.2. Specific Aims

The specific aims of this research are:

1. To explain the economic reform policy applied by the government of the People's Republic of China.
2. To punctuate the underlying reasons for the government of the People's Republic of China in applying those policy.
3. To describe the development of the People's Republic of China's economy after the policies were applied.
4. To see the prospect of the People's Republic of China's economy relating to economic globalization.

III.3. Research Coverage

This research covers the problems related to the application of the economic reform policy in the People's Republic of China. Comprehensible economic reform with a set of development policies in agriculture, industry, service, and institution sectors will be studied as a significant factor in apprehending economic dynamics in the People's Republic of China.

I.4. Analytical Framework

According to the Wikipedia, an economic system is a mechanism that regulates basic problems in the economic life of a certain society, which are related to production, distribution, and consumption of goods and services. Production is a set of activities in producing goods by means to be traded. Production decisions are related to what products will be produced, how to produce them, how to use inputs, and what is the production cost. In macroeconomics, aggregate production is measured in the form of the GDP and national income. The economic system also reflects the rank of the institution owned by the state or society, in terms of motives, material incentives, surveillance patterns, and ownership patterns, to run their economic functions.

Meanwhile, consumption is the use of resources in the form of goods coming from the production process of a certain society. According to Keynes,

the society consumption basically shows individual consumption expenditure that is influenced by the propensity to consume. Consumption is a part of aggregate demand, which is the demand for goods and services of all the society. Consumption can be generally defined as the choosing, using, and consuming of goods and services. Meanwhile, distribution is a problem of how to share goods and services coming from a production process among all the members of a society. Distribution can be operated through government planning or value mechanism decided by the market.

Based on those concepts, economic systems applied in a certain society consist of several elements: people, institutions, and interaction between people and institutions. An economic system is needed to rule the individual and the society in facing economic problems, which is the scarcity of resources or the imbalance between society's needs and available production factors. Economic systems are closely connected with ideology and the political system. In this context, ideology as a value system, which is believed in by the society, is transformed into the political and economic systems. For example, the communist ideology in the Eastern European countries in the Cold War era used singular party, communist party, and planned economy systems for their governance systems.

According to Wikipedia, economic systems are very varied and differ from one country to another. Those systems are part of social system and hierarchically at the same level with law and political and cultural systems occurring in the society. Economic systems primarily consist of four main systems:

- Market economy, related with capitalist ideology.
- Mixed economy, stands between capitalism and socialism.
- Planned economy, related with socialism ideology.
- Traditional economy.

The People's Republic of China used a centrally planned economic system as its economic system before economic reform was implemented. This system is often apprehended as an economic system in which economic decisions are made centrally by the planners who decide: the kinds of goods and services to be produced, how priced, how distributed, and the ownership of production devices. This system is also often apprehended as a command economic system since the pricing mechanism is decided through a command line. The command givers are the central governance planners who are a part of the state institution, so this system is also known as an etatism economic system.

This system has already been tested in communist countries and failed since those countries, such as the Soviet Union, always defaulted in fulfilling the basic needs of the society. For example, the planners were more concerned in the production of agricultural machinery rather than the production of clothes and shoes, so the society had to queue for a long time to get those things. In addition, this system placed the state in a position where its role became too great so that it interfered in individual lives. For example, if the state had already decided the kinds of jobs, people cannot create a new job beyond the jobs that have already been decided by the government. When there was scarcity of goods (for example, housing or nourishment material) in a certain area, the members of society were not allowed to move since the state did not plan for production in the new places.

The market economy refers to the market concept. Market is often apprehended as a place where sellers and buyers meet. Nonetheless, in the wider context, market covers all the economic decisions and individual acts that are related to the displacing of money, goods, and services, which are done voluntarily without any force. Thus, a free market economy is an economic process that covers production, consumption, and distribution of goods and services, regulated by free market mechanisms. A free market mechanism has a similar comprehension with the market concept and a free market where the pricing and production allocation are decided by the supply and demand of

a product. While a mixed economic system is a market economic system that still gives some space for the state to interfere towards the running of a market mechanism.

Most of the countries using market mechanisms call themselves socialist countries even though, a planned economic system, most of the time, is not viewed as an important element of the socialist concept. A planned economic system most of the time is viewed as a tool to actualize socialist ideology in social life practice. The application of the market economy, called a social democratic system, actualized socialist aims in Western European countries. Meanwhile, the People's Republic of China actualized socialism through a socialist market economy, which relied on market mechanisms and socialist values inherited from Mao Zedong.

Economic reforms in the People's Republic of China (PRC) were generally interpreted as a transition from a socialist economic system to a socialist market economy by adopting a market economy. The transformation of an economic system is also accompanied by the transformation of ideology, social formation, production mode, and development model. As for that, those concepts should be comprehended to gain an integrated perspective in viewing problems related to economic reform. Ideology is a number of ideas followed by a group that covers the illustration of a certain social reality and forms values or targets that must be attained by the group.

Meanwhile, social formation is a really organized structure marked by a dominant production mode. The production mode is an overall productive power of society and the production relationship that relates to the production system, which is based on certain ownership forms of production devices. The capitalist production mode is a mode where the production devices belong to a certain class in the society. Most of the members of the society do not have the production devices and work as labour for the minority class, which owns those devices.

In connection with the economic reforms of the PRC, the Director of the China Economic Research, Professor Justin Yifu Lin explained the rela-

tionship between the economic transitions and the reflection of neo classic economy. The assumption used in the neo classic theory is that in a free market economy, a company is expected to gain profit which is socially acceptable without getting any help or protection. If that company is not profitable, then the company will be bankrupt and also be eliminated from the market. Those assumptions presumably occur in capitalist countries but they are less agreeable if they happen in a developing country undergoing economic transition. Several problems that often occur in economic transition are: shock therapy vs. piecemeal reform, comparative advantage and state planning, the prevalence of viability problems and state enterprise reforms.

The first problem is related to the radical and moderate economic reform model. Former communist countries in Eastern Europe, such as the Soviet Union tried to carry out the economic transition by completely following the assumption constructed by the neo classic theory. The steps that were taken were to stop all the state subsidies, to fix the price based on the market mechanism (price liberalization), and to privatize state enterprises. Meanwhile, the People's Republic of China used a more moderate approach by keeping subsidies on several state enterprises and allowing private enterprises to enter the market. In fact, the Soviet Union's economy was not stronger than that of the PRC. In 1995, the Soviet Union's GDP only reached half of its 1990's GDP. While the PRC was able to increase the average GDP per year to 10% with the average trading level growth per year of about 15.2% in the period 1990-2001.

The Soviet Union together with several countries in Asia and Latin America, put in radical reforms in the money market following the recommendations of the IMF and the World Bank. These recommendations were in accordance with neo classic economic assumptions. They resulted in the economic recession and the monetary crises that hampered political and social stability at the end of 1997. Prof Justin (2003) says that the causal factor of the failure was the viability assumption, which only focuses on the proprietary right problem, corporate governance, state intervention, and enterprise management. Whereas, the PRC kept its independent reform policy line without following the radical reform system that is more directed to a neo liberal policy.

The second problem was related to the relationship between the state and the market. In economic transition in several countries, many of the enterprises did not get the benefits even though they were well managed. This was caused by the dispossession of the comparative advantage due to the inconsistency of the production of goods and the technology options to make a production with the comparative supremacy of those countries. The non-profitable enterprises might have been caused by the endowment factor, such as capital, labor, and natural resources ownership. To avoid this, the state had a reason to push the enterprises to disregard the comparative supremacy. For the sake of national security, the state is able to interfere in the capital based enterprises, for example, armament production. The subsidies, such as direct subsidies, were impeding the trading, pressuring the interest and salary rates and controlling income distribution.

The third problem was concerned with the needed viability to support the success of the economic reform programs. To increase this capacity, the developing countries often have to cope with a lot of troubles, such as work mentality and economic crises. The recommendation from the IMF to developing countries to overcome the crises and to increase their capacity resulted in a bigger crisis. One of the unpopular options was that if the enterprises did not have capacity the state did not allow them to go bankrupt; and to avoid the bankruptcy the state readjusted the structure of the capital enterprises to support the construction of an economic surplus. To have a maximum economic surplus, every state should have comparative supremacy. The state has an important role in facilitating the coordination between the enterprises and the domestic industries.

The fourth problem was that the reform of state enterprises experienced many failures and created social burdens most of the time. For example, the efforts to create an autonomous management, including the decision on benefit sums and coordination with other enterprises at several stages. It was actually able to improve the productivity on one side but unfortunately it decreased the benefits on the other side. Another step that had to be taken in

order to reform the state enterprises was to reform the proprietary rights or to create a modern corporate system that enabled the enterprises to sell their shares though, these caused the diversion of assets, the speculation, and the manipulation of the share market.

Another step that could be taken by the government was to divert the social burden from the state to the state enterprises. Before the reform, there had not been a policy to lessen the number of workers in industrial sectors since the state had given them jobs and salaries, including their retirement schemes. After the reform policies were applied, the enterprises had to deal with an option to reduce the number of workers. Thus, enterprises had to be responsible for the compensation. Now, almost all enterprises must insure pension money for their workers. The problems that occurred in the state enterprises during that time in China were lower productivity (25-45%), rampant corruption, and gaps between one and another. The low work productivity was the root of those problems.

In this case, the state had the basic role to save the state enterprises, including encouraging their economic growth, to widen the available work scope, and to create a social work system. Related to the reform policies, the enterprises were advised to follow recommendations. First, when the output of the enterprises was connected with national security or public necessity, then the government absolutely had to support those enterprises. Second, the enterprises with a large domestic market were encouraged to attract international assets. Third, the enterprises that did not have an adequate market place were encouraged to change their product according to the market demand.

I.5. Research Method

I.5.1. Study Approach

This research was done by using a qualitative approach. Although the object of this research was related with economic problems, but it will be viewed and explained descriptively.

I.5.2. Analysis Model

The data acquired for this study will be analyzed by the use of a descriptive analytical analysis model. And the analysis approach that will be used is the multi disciplinary approach that covers economic, social, historical, and political issues. The economic approach is using the development approach with market economy models. Historical analysis will be used to gain an illustration of causal factors of the economic policy since the Deng Xiaoping period of governance (1978).

I.5.3. Data Aggregation and Research location

The aggregation of data was done through literature study in libraries in Jakarta and Beijing. Besides the dictum study, there were also some interviews with several resource people in Beijing, such as the officials of the central CPC, the National Society Congress, universities, and the mass media. Scope research in Beijing was very important because besides the primary data; obtained directly from many groups taking part in the reforms; the secondary data are also needed. Without any scope research, we would not get a newer and deeper perspective about the changes; that have been occurring in China.

I.6. Strategic Aspects

The Republic of China is a big country, which is emerging from a period of having fallen behind. This country is now formulating an appropriate role in the international economy and political structure. Its open attitude in economic systems and its assertive behaviour towards the United States, has made this country one to be reckoned with in the world political constellation. Moreover, it has the biggest number of citizens in the world making the Republic of China an attractive potential market for western countries to expand their economies.

Related to that point, this research is expected to be able to give more complete information about social and economic conversions in the Republic of China and also to illustrate the change models of governance resulting from economic development. Thus, this study will have two important characteristics. First, it can illustrate the economic dynamics of the Republic of China resulting from the economic reform policy. Second, it can explain the identification of economic reform problems as responsive efforts to globalization in developing countries. Third, it can identify the problems as responsive effort to globalization in developing countries.

I.7. Writing Structure

The last report of this study is planned to consist of five writing chapters as follow:

Chapter I INTRODUCTION

This chapter will depict the background, the aim and problem formulating, research method covering approach/analysis model/scope data aggregation, and analytical framework. This chapter will also explain the governance, demography, and economic administration of the People's Republic of China.

Chapter II THE UNDERLYING FACTORS OF ECONOMIC REFORM

This chapter will depict the factors that affected the transition from communist economic system to market economic system. Those factors were the conversion of Mao's radical development strategy, the leadership changes, the economic growth orientation, and international factor. This chapter will also explain the causal factor of economic reform related to historical sectors, such as the economic policies from Mao Zedong era, including the Great Leap Forward program and cultural reform.

Chapter III THE ECONOMIC REFORM POLICY (1978-2003)

This chapter will describe what is called as economic reform, the kind economic reform policy, and the application of market economy as an alternative to Mao Zedong's radical development strategy. The economic reform will be looked at in three periods; 1978-1984, 1984-1991, 1992-now. The analysis of CPC Congresses' results will be the main references in writing this chapter.

Chapter IV THE ECONOMIC DEVELOPMENT IN AGRICULTURE, INDUSTRY, AND INVESTMENT

This chapter will describe the development of China's agriculture and industry from 1978 to 2004 and support of foreign investment. The readjustment of agriculture and industry since economic reform by Deng Xiaoping will affect China to move one step ahead in the global economic competition.

Chapter V ECONOMIC REFORM: IMPACT AND PROSPECT

This chapter will be the lid of the previous chapters. This chapter tries to describe the future of the People's Republic of China's economy relating to globalization and the international economic structure. How can the Republic of China adapt and solve the globalization challenges will be the main discussion of this chapter.

Chapter VI CONCLUSION AND RECOMENDATION

This chapter tries to draw a conclusion and make recommendations for public policies. Policy recommendations are addressed to both the Chinese and the Indonesian Governments.

CHAPTER II

THE UNDERLYING FACTORS OF ECONOMIC REFORM

By *Paulus RæDÖLF Yuniarto*

"Without reform there will be no way out for China. If reform is not carried out today, It will have to be carried out in the future, but that will only prolong China's backwardness."

— Zhao Ziyang

II.1. Introduction

China's economic reform towards a market oriented economy began in 1978 and has been recognized as essentially successful. China introduced successful market oriented privatizing reforms in the presence of communist dictatorships, which show no signs of weakening. China's economic growth and institutional transition in the last quarter century are both regarded as a success. China's economic growth qualifies as a miracle in terms of both magnitude and speed. China's institutional transition before 1978 adopted a gradual approach contrasting with the shock therapy adopted by the former Soviet Union and Eastern European countries which were experiencing many failures in developing their economy and political condition into a solid system.

The success of developing China's economic system began when China was under governance of Deng Xiaoping. Two years after the death of Mao Zedong in 1976, it became apparent to many of China's leaders that economic reform was necessary. The attempt to reform the Chinese economy was caused by the willingness of the CPC not only to better the people's living standard but also to fulfill the political purpose. Improving economic performance and raising living standards were required to restore the CPC prestige. The traumatic experience of the Great Leap Forward and the Cultural Revolution had

eroded popular trust in the moral and political virtue of the CPC. The party's leaders decided to shift the base of party legitimacy from virtue to competence.

Deng Xiaoping, the successor of Mao intended to change the condition of the economy by using the 1978 resolution in two ways: by expanding foreign trade and by encouraging foreign companies to invest in Chinese enterprises. In this way China's economic reform process had both mass appeal and was accelerated. Deng Xiaoping initiated a new policy by 'taking class struggle as the guideline' to taking economic construction as the central link, starting reform and opening up the economy.

This chapter will describe factors that influenced the development of the economic reform of China since the end of the leadership of Mao Zedong to the beginning of the period of leadership of Deng Xiaoping. But, before this, this chapter will describe China's demography and geography that greatly influence the analyses of the current performance of the Chinese economy.

II.2. Chinese Profile

II.2.1. Geography

The People's Republic of China is situated in East Asia, on the western shores of the Pacific Ocean. It has a land boundary totalling over 22,800 kilometres, contiguous with 15 countries, adjoining the Democratic People's Republic of Korea in the east; Mongolia in the north; Russia in the northeast and Kazakthan; Kirghizstan and Tajikistan in the northwest; Afghanistan; Pakistan; India; Nepal; Sikkim and Bhutan in the west and southwest; and Burma; Laos; Vietnam in the south. Across the Yellow Sea to the east are the Republic of Korea and Japan, and across the East China Sea and the South China Sea to the southeast and south are the Philippines, Malaysia, Indonesia and Brunei. China has a total land area of about 9.6 million square kilometres, after Russia and Canada, the third largest country in the world.

Picture 2.1
Map of China



The territory of China from north to south, measures some 5,500 kilometres, stretching from the centre of the Heilongjiang River north of the town of Mohe (latitude $53^{\circ}30'N$) to the Zengmu Reef at the southernmost tip of the Nansha Island (latitude $4^{\circ}N$). When north China is still covered with snow, people in south China are busy with spring ploughing. From west to east, the country extends about 5,200 kilometres from the Pamirs (longitude $73^{\circ}4'E$) to the confluence of the Heilongjiang and Wusuli Rivers (longitude $135^{\circ}5'E$), with a time difference of over four hours. When the Pamirs are cloaked in night, the morning sun is shining brightly over east China.

At present, China is divided by the central government into 4 municipalities: Beijing, Shanghai, Tianjin and Chongqing; 2 special Administrative Regions: Hong Kong and Macao; 23 provinces: Anhui, Fujian, Gansu, Guangdong, Guizhou, Hainan, Hebei, Heilongjiang, Henan, Hubei, Hunan, Jiangsu, Jianxi, Jilin, Liaoning, Qinghai, Shannanxi, Shandong, Shanxi, Sichuan, Taiwan, Yunnan, Zhejiang; and 5 autonomous regions: Guangxi, Nei Mongol (Inner Mongolia), Ningxia, Xingjiang and Xizang (Tibet). Those administrative divisions make the central government more effective in coordinating and controlling the country.

II.2.2. Demography¹³

Chinese people have been recognized as being of an advanced progressive nation with a high civilization. Chinese people are known as pioneers and deliverers of progressive values in world society, among other things in its education system, medication and health system, artistic, ceramic technology, architecture, art, astronomy and even its troops in war. China is a trading country, where the local residents have the sense of economy and they are also resilient and hard working. Many Chinese people migrate to many parts of the world and stay there but they still maintain their own culture. So, that is why Chinese people and their culture (often called the Yellow River culture) are influential in Southeast Asia and some states outside China. In culture, the Chinese culture could be defined as central. In the nation itself there is an emerging opinion that local people believe China is the centre of the world: *Zhongguo* in the Chinese language, and the centre of world activities.

China has 56 ethnic groups forming a united, multi ethnic country with the Han people as the majority (91.59 % of the total population) and the rest a minority. The Han people can be found throughout the country, though most

¹³ This part write base on book entitled: A Passage to China. Aspects of Culture, Education, Business, Tourism and More with Chief Editor: Ning Aihua and Li Zhonghua. China Ocean University Press, 2004. page 1 - 19

of them live in the middle and low lands of the Yellow River, the Yangtze River and the Pearl River valleys, and the Northeast Plain. The national minorities, though fewer in number are scattered over a vast area, in approximately 64.3% of the Chinese territory, and most of them reside in the border regions from north eastern China to northern, north western and south western China. Yunnan Province, home to more than 20 ethnic groups, has the greatest diversity of minority people in China. The largest minority ethnic group is the Zhuang, totalling about 15.6 million people; while the Lhoba, the smallest, has only a little more than 2,300 people.

The Han people have their own spoken and written language, known as the Chinese language which is commonly used throughout China. The Hui and Manchu ethnic groups also use the Han (Chinese) language. The other 53 ethnic groups have their own spoken languages and 23 ethnic groups have their own written languages. The name Han originates from the Han Dynasty, dating back over two thousand years.

In most Chinese cities and towns, two or more ethnic groups live together. Taking shape over China's long history, this circumstance of different ethnic groups 'living together in one area while still living in individual compact communities in special areas' continues to provide the practical basis for political, economic and cultural intercourse between the Han and the various minority people, and for the functioning of the autonomous national minority areas.

However, according to the two Communiqués on major Figures of the 2000 Population Census by the National Bureau of Statistics, the People's Republic of China, from the result of the Fifth National Population Census of China, on 28 March, 2001 and on 2 April, 2001 respectively, the population of China reached 1,295,33 million (including 1,165,83 million on the mainland, 6.78 million in the Hong Kong Special Administrative Region, 440,000 in the Macao Special Administrative Region and 22.28 million in the Taiwan Province and in Jimen, Mazu and a few other islands of the Fujian Province).

Population growth on the mainland, compared with the population of 1,133.68 million from the 1990 population census (with zero hour of 1 July 1990 as the reference time), increase by 132.15 million persons, or 11.66 % over the past 10 years and 4 months. The average annual growth was 12.79 million persons, or a growth rate of 1.07%.

The results show that there were 348.37 million family households with a population of 1,198.39 million people on the mainland. The average size of a family household was 3.44 people, or 0.52 people fewer when compared with the 3.92 people of the 1990 population census; the gender composition of the mainland, 653.55 million people or 51.63 % were male, while 612.28 million people or 48.37 % were female, and the gender ratio (female=100) was 106.74; the age composition on the mainland, 289.79 million people were in the age group of 0-14, accounting for 22.89 % of the total population; 887.93 million people in the age group of 15-64, accounting for 70.15 %, as compared with the result of the 1990 population census, the share of people in the age group of 0-14 was down by 4.80 percentage points, and that for people aged 65 and over was up by 1.30 percentage points.

The results also show that the composition of nationalities on the mainland was 1,159.40 million people or 91.59 % were of Han nationality, and 106.43 million people or 8.41 % were of various national minorities. Compared with the 1990 population census, the population of Han people increased by 116.92 million people, or 11.22 %; while the population of various national minorities increased by 15.23 million people, or 16.70 %.

In educational attainment, for the mainland, 45.71 million people had finished university education (junior college and above); 141.09 million people had received senior secondary education (including secondary technical school education); 429.89 million people had received junior secondary education and 451.91 million people only had primary education.

According to the census, on the mainland of China, 85.07 million people were illiterate, but compared with the 15.88 % of illiterate people in the 1990 population census, the proportion had dropped to 6.72 % from 9.16 percent-

age points. On the mainland of China, there were 455.94 million urban residents, accounting for 36.09 % of the total population; and that of rural residents stood at 807.39 million, accounting for 63.91 %. Compared with the 1990 population census, the proportion of urban residents rose by 9.86 %.

China is a large agricultural country in East Asia with a great civilization that goes back over 5,000 years. China can be said to have the largest population of people in the world and also it is a big agricultural and industrial country. From the explanation of the Chinese demography and geography, China definitely has great potential to increase its economic growth.

Table 2.1
China Country Profile

Country Profile of China		
1	Population:	1,288,679,000
2	Population growth (%):	0.9 _a
3	Capital City:	Beijing 10,849,000
4	Area:	9,596,960 sq km (3,705,405 sq mi)
5	Population:	1.3 billion (UN, 2005)
6	Major language:	Chinese (Mandarin), Cantonese, other dialects and minority languages
7	Major religions:	Buddhism, Christianity, Islam, Taoism
8	Life expectancy:	70 years (men), 73 years (women) (UN)
9	Monetary unit:	1 Renminbi (Yuan) (Y) = 10 jiao = 100 fen;
10	Main exports:	Manufactured goods, including textiles, garments, electronics, arms
11	GNI per capita:	US \$1,100 (World Bank, 2005)
12	GDP Per Capita	U.S. \$4,700
13	Internet domain:	.cn
14	International dialing code:	+86
15	Literacy	86%
16	Economy	<p>Industry: iron and steel, coal, machine building, armaments, textiles and apparel, petroleum, cement.</p> <p>Agriculture: rice, wheat, potatoes, sorghum; pork; fish.</p> <p>Exports: machinery and equipment, textiles and clothing, footwear, toys and sporting goods, mineral fuels.</p>

Sources: <http://plasma.nationalgeoGraph.com/mapmachine/profiles/ch.html>

II.2.3. Economic Disorder during China's National Crisis

This part of the chapter will describe the economic situation before economic reform was introduced in China. The reform era actually has currently occupied almost half the life of the People's Republic of China. In the past quarter of the 20th century, China experienced the longest period of political order and coherent national policy making in China because the industrial revolution in Europe and North America began to exercise profound influence over Chinese life from about 1840. The beginning of the era of Chinese disorder and incoherence that has recently receded into history is marked by the eclipse of China by the United Kingdom as the world's largest economy, and by the coincidental First Opium War and the colonization of Hong Kong.

Background and characteristics of China's economic reform can be seen from the communist government when they took over mainland China in 1949, and adopted Marxist doctrines as the guiding principle of their economic system.¹⁴ After the establishment of the People's Republic of China (PRC) in 1949, mainland China underwent a fundamental change in its political and economic system. The new system was based on Marxist Leninist philosophy and its economic doctrines were borrowed from the former USSR and other communist countries in Eastern Europe.

The sluggish economic growth and the damages caused by the political struggle of the Great Leap Forward (1958-1960) and "Cultural Revolution" from 1966 to 1976 created serious problems in China in the late 1970s. It was a new experiment for China, and its implementation was marked by serious economic setbacks and great social turmoil, particularly during the Great Leap Forward and the Cultural Revolution.

Those Maoist economic policies had created two severe national traumas that seared the national consciousness, and sowed the seeds for subse-

¹⁴ Garnaut, Ross, 2004, *The Origins of Successful Economic reform in China*. Paper presented at the Tenth Anniversary of the China Center for Economy Research, Peking University, Beijing, 16-17 September.

quent attitudinal changes on the central plan, state ownership, political order, and international relations¹⁵. The Great Leap Forward starved 30 million Chinese to death; and the Cultural Revolution decimated the administrative structures of the Party and the government, and plunged the country into a big witch-hunt. Fairbank (1987) estimated that the Cultural Revolution purged 30% of Party officials, and 75% of the top economy officials; and persecuted more than 700 000 people, of which about 35 000 died.¹⁶

The process of imposing socialist welfare in the countryside took the form of gradually combining the production units in order to equalise the income received by the rural population. Mao's achievement was followed up with the Great Leap Forward program of crash industrialisation in May 1958. To catch up with the capitalist West, the Party announced that steel production in 1958 was to be double that of 1957, which was 5.35 million metric tonnes. Backyard steel mills sprang up all over rural China, drawing labour from agricultural production, melting down farm and cooking implements to make steel and deforesting the land for the required fuel.

The leftist economy program of Mao Zedong, which was dedicated to egalitarianism enforced on the bulk of the population through large agricultural communes, and dedicated to ideological purity enforced by basing promotions on being "red" in political orientation rather than being "expert" in economic management. Mao's leftist program caused big gyrations in output, and much human suffering in the period of the "Great Leap Forward" economic strategy. National income (according to the soviet definition) grew 22 % in 1958 but plummeted 30 % in 1961, causing 30 million Chinese to die of starvation.

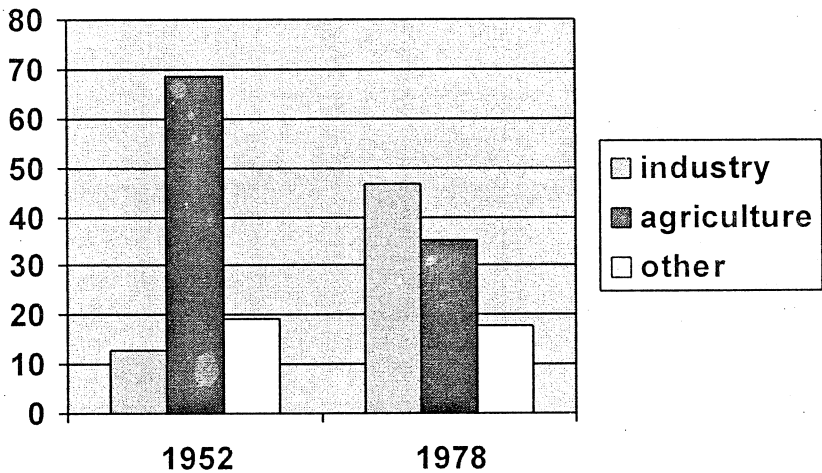
The special situation in the 1950s made China choose heavy industry as a development strategy, and as a consequence, the command economy was

¹⁵ Woo, Wing Thye, 1999, *The Economy and Politics Of Transition To An Open Market Economy: China*. P. 17

¹⁶ Fairbank, J. (1987). *The Great Chinese Revolution: 1800-1985*, Perennial Library, Harper and Row in Woo. *ibid* p.17

chosen to reach that goal. The root of economic decision policy caused China to develop slowly before the introduction of the reforms; the adoption of a heavy industry oriented development strategy in a capital scarce economy that had an anti comparative advantage strategy.

Graph 2.1
Indicators Development in Pre Economic reform



Sources: <http://www.econ.umn.edu/~alicesch/GL1.doc>

Table 2.2
Average annual rates of growth of selected Economic Indicators
(in percentages)

	Period 1952-1979 (Pre-Reform)
Real GDP	6.20
Real GDP/Capita	4.14
Real Gross Value of:	0.00
Agricultural Production	4.33
Light Industry	7.83
Heavy Industry	11.37
Real Personal Consumption	4.99
Real Consumption/Capita	2.96
Real Gross Fixed Capital Formation	11.43
Capital Stock	5.93
Employment	2.52
GDP Deflator	0.59
Retail Price index	0.80
Exports (in current US Dollars)	10.98
Imports (in current US Dollars)	10.27

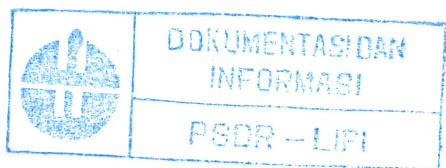
Sources: J. Lau, Lawrence, 2000, Economic reform without Losers: The Experience of the People's Republic of China and Its Applicability to North Korea. Department of Economics Stanford University.

The period of 1949-1978 was recognized as the period of the *Command Economic System*, over about 30 years, the goal of economic construction was not achieved, and the Chinese people's living standards remained at subsistence level with little improvement throughout the period. An example of this system is the treatment of the agricultural sector. Land was distributed to the peasants in the post liberation euphoria of 1949-1952. However, private ownership of land was not to last. Private ownership contradicted the CPC's, particularly Mao's, commitment to egalitarianism and common property. These realities in China in the 1950s show the situation; (1) capital was scarce and its price was very high. (2) China had an abundant labour force and the wage rate was really low.¹⁷

This awareness changed the economy and political thoughts of people and China's government. They used "shock therapy" as a solution to their problems. Instead of using this radical policy, China followed the 'trial and error' approach for the correction. Starting in 1979, China began a series of "trial and error" economic reforms. This gradual change policy is the first characteristic of China's economic reform. The second characteristic is that rural reform came before urban reform in the early stages of economic transformation. The third is China's "open door" policy. The government opened most coastal cities for foreign investment. The fourth is the coexistence of socialism and capitalism.

Its end is marked with even greater clarity by Deng Xiaoping's ascendancy at the third Plenary Meeting of the Chinese Communist Party's 11th. Central Committee, in December 1978. The beginning and the end of China's period of disorder and economic underperformance are both linked to profound changes in China's relations with what are now the advanced economies.

¹⁷ Zhang, Jing, *The China Economic reform. From The Command System To The Market System*. <http://www.econ.umn.edu/~alicesch/GL1.doc>



II.3 Economic reform in China: Background Factors

II.3.1. Strategy of State Development Factor¹⁸

The Transition to Socialism, 1953-1957. Beginning in the early 1950s the economic planning that was introduced in China was modeled on the planning system of the Soviet Union. The first Five Year Plan was initiated in 1953 and officially designated “The Transition to Socialism, 1953-1957”. This period was characterized by efforts to achieve industrialization, collectivization of agriculture, and political centralization.

The First Five Year Plan stressed the development of heavy industry on the Soviet model. The Soviet economy and technical assistance were expected to play a significant part in the implementation of the plan, and technical agreements were signed with the Soviets in 1953 and 1954. For the purpose of economic planning, the first modern census was taken in 1953; the population of Mainland China was shown to be 583 million, a figure far greater than had been anticipated.

Among China’s most pressing needs in the early 1950s were food for its rapidly increasing population, domestic capital for investment, and purchase of Soviet-supplied technology, capital equipment, and military hardware. To satisfy these needs, the government began to collectivize agriculture. Despite internal disagreement as to the speed of collectivization, which at least for the time being was resolved in Mao’s favor, preliminary collectivization was 90 % completed by the end of 1956. In addition, the government nationalized banking, industry, and trade. Private enterprise in Mainland China was virtually abolished.

The Great Leap Forward, 1958-1960. In 1958 the CPC launched the Great Leap Forward campaign under the new “General Line for Socialist Construction.” The Great Leap Forward was aimed at accomplishing the economy

¹⁸ For complete history of China in general could be downloading in the address <http://www-chaos.umd.edu/history/republican.html#republic>. Article download in March 22, 2005

and technical development of the country at a vastly faster pace and with greater results.

The shift to the left that the new “General Line” represented was brought on by a combination of domestic and external factors. The party leaders appeared generally satisfied with the accomplishments of the First Five Year Plan. Mao and his fellow radicals in particular, believed that more could be achieved in the Second Five Year Plan (1958-62) if the people could be ideologically stirred up and if domestic resources could be utilized more efficiently for the simultaneous development of industry and agriculture. These assumptions led the Party to an intensified mobilization of the peasantry and mass organizations, stepped up ideological guidance and indoctrination of technical experts and made efforts to build a more responsive political system.

The last of these undertakings was to be accomplished through a new *xiafang* movement, under which cadres inside and outside the party would be sent to factories, communes, mines, and public works projects for manual labor and firsthand familiarization with grass-roots conditions. Mao’s decision to embark on the Great Leap Forward was based in part on his uncertainty about the Soviet economic policy, financial, and technical assistance to China. That policy, in Mao’s view, not only fell far short of his expectations and needs but also made him wary of the political and economic dependence in which China might find itself. The economic programme of the party was based on four principles: common ownership, mass mobilization, centralization and self-sufficiency¹⁹.

The common ownership principle is the heart of communism. Common ownership is believed to be the ultimate moral state that society has been evolving towards ineluctably. It is regarded as the most effective means of generating income equality. More than morality and inevitability, a classless society is assumed to guarantee social harmony, hence allowing an economy

¹⁹ Woo, Wing Thye, 1999, *The Economics And Politics Of Transition To An Open Market Economy: China*. OECD Development Centre. P. 18

to maximize capital accumulation and to ensure its full use. Common ownership is thus the moral objective to be attained as well as a means of transforming China into a cornucopia.

The mass mobilization principle is the logical culmination of the guerrilla warfare strategy that put the CPC into power. Mao Zedong viewed 'mass mobilization' to be the most effective method of implementing economic reconstruction, using China's abundant labour power to compensate for its scarcity of capital and energy. Mao's essay "The Foolish Old Man and the Mountain", which preaches that diligence and perseverance can overcome all, comes close to putting mass mobilization as the equivalence of mind over matter. As a matter of fact, Mao, himself, regarded mass mobilization to be a goal in itself. To Mao, mass mobilization meant mass political participation, the only guarantee of egalitarianism against revisionism being imposed by bourgeois elements in the Party leadership. The mass mobilization principle in fact means putting "politics in command" of economics.

The centralization principle was borrowed from the Soviet Union. It replaced the political market place with democratic centralism, and the economic market place with central planning. In 1958, it was still possible to believe that administrative allocation was superior to market allocation. The market mechanism was suspect on ideological and economic grounds: Lenin and Stalin had equated the market with capitalism, and memories of the global Great Depression were still strong. Central planning appeared awesomely impressive in 1958: the Soviet Union had industrialized at a neck breaking speed, and it had beaten the United States in putting a satellite into space. In practice, the general plan emphasized investment over consumption, heavy industry over light industry, industry over agriculture, and agriculture over services. Soviet economic theory considered "services" to be so unproductive that most of them were not included in the socialist measure of the total output, Net Material Product.

The self-sufficiency principle was partly a matter of choice, and partly a matter of necessity. The forces within China to severely limit its dependence

on the outside world were ideological and historical in origin. Standard Marxist economic theory instructed the CPC that international trade should be allowed only to finance the import of goods that a country was incapable of producing, e.g. the import of tropical fruit by a temperate country. More important, perhaps, was that China's negative experiences with the capitalist countries in the preceding one hundred and fifty years had encouraged xenophobic tendencies that helped to translate political nationalism into economic nationalism.

However, during the implementation of the Great Leap Forward with a crash industrialization program, the Chinese fell into the same trap as the Russians, emphasizing quantity targets at the expense of quality improvements, with the unfortunate result that a large part of the final steel products was too low grade to be usable. The negative incentive effects from the collectivization of land, and the drawing of resources away from agriculture caused a calamitous decline in agricultural output. Over 30 million people starved to death in 1958-1961, and cannibalism was common in some.²⁰

Readjustment and Recovery, 1961-1965. In 1961 the political tide at home began to swing to the right, as evidenced by the ascendancy of a more moderate leadership. In an effort to stabilize the economic front, for example, the Party, still under Mao's supposed leadership but under the dominant influence of Liu Sao Xi, Deng Xiaoping, Chen Yun, Peng Zhen, Bo Yibo, and others, initiated a series of corrective measures. Among these measures was the reorganization of the commune system, with the result that production brigades and teams had more say in their own administrative and economic planning.

To gain more effective control from the centre, the CPC reestablished its six regional bureaus and initiated steps aimed at tightening Party discipline and encouraging the leading Party cadres to develop populist style leadership at all levels. The efforts were prompted by the Party's realization that the arro-

²⁰ Ibid, Woo, Wing Thye, page. 22

gance of Party and government functionaries had engendered only public apathy. On the industrial front, much emphasis was now placed on realistic and efficient planning; ideological fervor and mass movements were no longer the controlling themes of industrial management. Production authority was restored to factory managers. Another notable emphasis after 1961 was the Party's greater interest in strengthening the defence and internal security establishments. By early 1965 the country was well on its way to recovery under the direction of the Party apparatus, or to be more specific, the Central Committee's Secretariat headed by Secretary General Deng Xiaoping.

The Cultural Revolution, 1966-1976. In the early 1960s, Mao was on the political sidelines and in semi seclusion. By 1962, however, he began an offensive to purify the party, having grown increasingly uneasy about what he believed were the creeping 'capitalist' and antisocialist tendencies in the country. As a hardened veteran revolutionary who had overcome the severest adversities, Mao continued to believe that the material incentives that had been restored to the peasants and others were corrupting the masses and were counter revolutionary.

In 1966, Mao launched an innocuous sounding campaign, the Cultural Revolution, to revitalize the Party to prevent it from slipping into the self serving over centralized bureaucratic culture of the Soviet Union. Mao believed in regional self sufficiency and in administrative guidance of resource allocation, he favoured a localized command economy. His unquestioned authority during the Cultural Revolution enabled him to slash the number of central level bodies in order to transfer economic planning to the provinces. In June 1970, the number of central ministries and state commissions under the State Council was reduced from 54 to 26, and the number of State Council agencies was cut to 32 from 7829. Incentive schemes and private economic activities were forbidden, and ideological appeal to sacrifice for the greater good was the preferred method of raising productivity.

Agriculture was "re-collectivized", mostly up to the production brigade (about 250 households) level — instead of up the commune (about 4.500

households) level as in 1958-62. The party secretaries in the factories replaced the managers and engineers in the running the factories, and political exhortations (class struggle sessions) completely replaced material incentive as the means to motivate work effort. Promotion was increasingly based on ideological conformity rather than on technical knowledge (“better red than expert”). International trade was seen as a nuisance to be tolerated primarily because of technological necessity, and the national distribution system was allowed (or, more likely, made) to atrophy in order to promote local self-sufficiency²¹.

The consequences of “politics in command” of economic development were very disappointing, however, and even Mao was not pleased. The annual real national income growth rate averaged only 5.8 % in the 1966-1972 period compared to 15.3 % in the 1962-1966 period. The poor economic performance was ultimately a national security matter because China’s economy was getting less and less able to support a war against an invasion from a major power like its immediate neighbour, the Soviet Union. As Mao would not fault the ultra leftist policy for the poor results, he faulted the poor management of this policy by the Gang of Four for the lacklustre economic outcome.

II.3.2. Leaderships Factor

Among the interesting puzzles confronting the economics of transition in the era of Mao Zedong is that communist regimes led by him lost their monopoly of political power while others tried to replace it. The economy of China blossomed under communist led market reforms.

²¹ Ibid Woo, Wing Thye, P. 25

Table 2.3
Membership of the Standing Committee of the Politburo of the Chinese Communist Party²²

1. After the 8th Party Congress in September 1956:	Mao Zedong, Liu Sao Xi, Zhou Enlai, Deng Xiaoping, Zhu De, and Chen Yun
2. After the 9th Party Congress in April 1969:	Mao Zedong, Lin Biao, Zhou Enlai, Chen Boda, and Kang Sheng
3. After the death of Mao in September 1976:	Hua Guofeng, Wang Hongwen, Ye Jianying, Li Desheng, Zhang Zhongqiao, and Jiang Jing
4. After the 3rd Plenum of the 11th Party Congress in December 1978:	Hua Guofeng, Ye Jianying, Deng Xiaoping, Li Xiannian, Chen Yun, and Wang Dongxing

Sources: Nainggolan. Poltak Partogi, 1995, *Reformasi Ekonomi Era Deng Xiaoping. Pasar Bebas dan Kapitalisme Dihidupkan Lagi*. Pustaka Sinar Harapan, Jakarta. Data Processed.

The Table above shows the composition of the membership of the Standing Committee from the end of the 8th. Party Congress in September 1956 until the end of the 3rd Plenum of the 11th. Party Congress in December 1978.

The 1956 membership was elected at the first post victory Congress of the CPC. The top ranking member of the Standing Committee was Mao Zedong, the Chairman of the Party. The second ranking member was the CPC Deputy

²² Listed according to rank in the Committee

Chairman Liu Sao Xi who was the President of the country, and also Mao's chosen successor. Zhou Enlai was the Prime Minister, the person responsible for the working of the government. Deng Xiaoping was the General Secretary of the Party and a Deputy Premier. Chen Yun was a Deputy Chairman of the Party, and a Deputy Premier in the government, and was recognized for his expertise in financial and economic matters. Even though only Marshal Zhu De held a military position, the rest of the standing committee were veterans in the wars against the Japanese and the Kuomintang Party, and had very close ties with the army.

Liu Sao Xi, Zhou Enlai, Deng Xiaoping and Chen Yun were the "organization men" representing the (civilian) Party and state bureaucracies. The fact that the army representative, Marshal Zhu De, ranked fifth in the Standing Committee clearly showed that the Party was definitely in control of the "gun". The overall policy orientation of this standing committee was towards economic reconstruction implemented through Soviet style central planning. It is hard to characterize policy divisions within this standing committee because the 'emperor' culture was very much in evidence, Mao had disproportionate influence on the decisions of the committee.

Only one member (Premier Zhou Enlai) of the four "organization men" remained in the 9th. Standing Committee elected in April 1969. The Cultural Revolution was in full swing. Lin Biao, the head of the army, was the second ranking member of the Standing Committee, and the newly designated successor to Mao, Lin Biao was the editor of a collection of Mao's sayings, the famous 'Little Red Book' that became the bible of the Red Guards, the shock troops that Mao used to attack his colleagues. Kang Sheng was the head of the secret police, and Chen Boda had formerly been Mao's secretary. The important point about the changes in the standing committee is that Mao's rule had become more imperial and personality oriented and one result was that the Party became more dependent on the military and security apparatus.

At the beginning of the Cultural Revolution, Mao used his wife, Jiang Jing, as a channel to attack his political enemies. Over time, Jiang Jing and

three close collaborators (Wang Hongwen, Zhang Chunqiao and Yao Wenyuan) came to represent the most radical aspects of Mao's political philosophy (which could be summarized as "politics in command of everything"). Mao, once in a moment of pique, described them as a "Gang of Four", a term that was used by their enemies after their political downfall in 1976.

With the worsening of economy conditions, the death of Lin Biao in September 1971 after the failure of his plot to assassinate Mao, and the declining health of Premier Zhou Enlai, Mao Zedong reappointed Deng Xiaoping as Deputy Premier in March 1973. In January 1975, Deng was elected to the Standing Committee, and reappointed Deputy Chairman of the Party. Deng was dismissed (for the second time) from his Party and government posts after the Tiananmen riots in April 1976. Mao died in September 1976

The highest ranking member of the Standing Committee in September 1976 was Hua Guofeng, a relative newcomer with no clear constituency within the Party, the government or the army. Hua was the head of both the Party and the government; he was the Party Chairman as well as the Prime Minister. Hua was selected by Mao to be the Prime Minister in January 1976 as the compromise candidate between Deng Xiaoping who had the support of the administrative cadres and Wang Hongwen who had the support of the radical leftists. On his deathbed, Mao designated Hua to be his successor with the now famous comments: "*With you in charge, I am at ease*".

The standing committee was dominated by two groups: the radical leftists represented by Jiang Jing, Wang Hongwen and Zhang Zhongqiao, and the army represented by Ye Jianying and Li Desheng. The composition reflected the turmoil that the country had gone through in the Cultural Revolution over the previous ten years. There were two army generals because the army was the only institution that had a strong national network under centralized control. The army was enforcing the rule of Mao over the competing political factions. Army commanders assumed effective Party leadership in many regions. In effect, the "gun" was in effective command of the Party outside Beijing.

Within a month of Mao's death, the army arrested the Gang of Four. Deng Xiaoping was restored to all his former posts in July 1977. The Third Plenum of the 11th Central Committee held in December 1978, launched China's market oriented reforms. The Third Plenum also reelected to the Standing Committee, Chen Yun, who had been a member of the 1956 Standing Committee. Hua Guofeng remained the top ranking member of the Standing Committee. The two factions within this Standing Committee were the Maoists (Hua Guofeng, Wang Dongxing, Ye Jianying and Li Xiannian) and the rehabilitated cadres (Deng Xiaoping and Chen Yun).

II.3.3. Economic Development Factor

It was in 1978 that China started to abandon the planning system gradually and return to a more market oriented economy. From the explanations in many articles by Chinese government official as to why reform was initiated, the reply was that the Communist Party simply resumed the course for developing the Chinese economy as set forth in the four modernizations (of agriculture, industry, science and technology, and defence) announced by Premier Zhou Enlai in December 1964.

The plan for modernization was interrupted by the Cultural Revolution of 1966-1976, and should be resumed as soon as the Cultural Revolution subsided. Of course, even if the Communist Party had had some plan for developing the Chinese economy it might take a different course later under a different set of circumstances. It had adopted a planning system in the 1950s but decided to abandon it. In keeping with Gregory C. Chow (2004).²³ I would like to propose the following as the possible reasons for economic reform introduced in 1978: First, the Cultural Revolution of 1966-1976 was very unpopular. The Chinese Communist Party and the government had to change

²³ Chow, Gregory C. 2004, *Economic reform and Growth in China*. Journal Annals Of Economys And Finance 5, 127-152

direction in order to get support from the Chinese people. Party Chairman Mao Zedong who engineered the Cultural Revolution died in 1976. The Gang of Four who seized power and supported that ruthless political movement was soon eliminated. Deng Xiaoping became the leader of China because the top Party leadership supported him. It was time for him to make the move to change.

Second, many economic planners had learned from experience that a planning system was difficult to manage and economically inefficient. This is witnessed by the writing of economic officials that appeared in the late 1970's, although the understanding of the weakness of the planning system varied among these officials.

Third, rapid economic growth and development that took place in the more market oriented neighbouring economies served as examples that a market economy could perform better. The neighbouring economies included Hong Kong, Taiwan, South Korea and Singapore. The contrasts in the economic performance between North and South Korea, between East and West Germany, and between Eastern and Western Europe reinforced this point.

Fourth, for the reasons stated above the Chinese people desired a market oriented reform and would support it. The Chinese people had also suffered through the economic consequences of central planning, including the shortage of consumer goods, the limited variety and the lack of improvement in quality. They had to know the suppliers of consumer goods and waited in long lines to get what was needed. They had to go through the 'back door' (or use personal connections) to get what was considered essential consumer goods.

Given these four reasons, economic reform seemed inevitable. There were also supporting human factors favouring the initiation of economic reform. First was the person of Deng Xiaoping. Before Mao died he had designated Hua Guofeng to succeed him as Chairman of the Communist Party. Deng had to take over the leadership from Hua before trying to reform the economic system. Deng's leadership during the reform process was recognized as important. However, given the above four reasons another leader who

was able to gain support from the Party leadership and the Chinese people would have had to initiate changes, even if not as effective as Deng.

II.3.4. External Factor

In the 1950s, western countries launched a series of campaigns to politically isolate and economically obstruct China. As a consequence, China had poor international political and economic relations, and had to be ready for war at any time. It was impossible for China to choose labour intensive light industry and trade with other countries for capital at that time. China needed to create a new approach to economic development.

Besides, for social and economic development in East Asia (1970) at the time of maturation of Japan's postwar expansion and at the height of internationally oriented growth of what was called the newly industrialized economies it was the right place and the right time. It was the right place, because geography matters to trade and investment flows and to the international transmission of ideas about economic development strategy and policy.

A prosperous Chinese business community in East Asia outside the People's Republic was ready to respond on an immense scale to the new opportunities in China's opening to the international community. The proximity of the Chinese business diasporas in Hong Kong, Taiwan and Southeast Asia facilitated the response. China had to accept that domestic and international exchange through markets was necessary and also to accept the components of a national development strategy.

However, China's economic reform was often distinguished from the market reform of the Soviet Union and many former socialist countries in Eastern Europe. China had to change but not leave the characteristics themselves. The failure of the socialist countries to develop themselves was a lesson for China in building its economic development. First, unlike the case of the Soviet Union, China did not change its political system and was able to maintain political stability. Second, China's reform process did not have a

blueprint. Each step was taken after drawing from the experience of the previous step. Under the leadership of Deng, the process was like a person walking across the river by feeling for rocks at each step.

This characteristic was necessitated by the lack of knowledge of the leaders of what kind of market economy was suitable for China. They had to learn by experimentation. Secondly, experimentation helped convince the party members of the validity of the new institutions. The slogan 'to build an economic system with Chinese characteristics' was introduced in the early 1980s and remains in constant use in the early 2000s. 'Chinese characteristics' means the results of experimentation that were shown to work for China. This slogan also implies that the Chinese leaders were pragmatic and not confined to a set of old Communist ideologies. Recall Deng's famous statement, 'it does not matter whether a cat is black or white as long as it catches mice' Pragmatism over ideology is an important trait of China's reform process.²⁴

II.4. Conclusion

The topic of this essay is the background of economic reform in China. In summary, economic reform consisted of changes in economic institutions toward those of a market economy, with the changes taking place step by step depending on the results of and experience gained in previous steps. In the meantime there were significant changes in economic institutions as described above. The following factors account for the success.

Note that economic growth was important for carrying out further economic reforms. Without growth, reform would not and could not have proceeded because the reformers would have lost confidence and the support of the Communist Party members and the Chinese people. The first two factors stated below account for the rapid growth once the basic elements of a market

²⁴ Nainggolan, Poltak Partogi, 1995, *Reformasi Ekonomi Era Deng Xiaoping. Pasar Bebas dan Kapitalisme Dihidupkan Lagi*. Pustaka Sinar harapan, Jakarta. p.81-110

economy were introduced. Basic elements like the freedom and opportunity to make money by Chinese citizens through hard work and ingenuity, with rewards dependent on ability and effort, and economic success dependent on superior performance under a somewhat competitive environment.

The core of China's economic reform is to exploit the comparative advantage. The basic content of the economic reforms was:

1. Transform from the command economy to the market economy
2. Focus on the development of the light industry
3. Change from closed economy to open economy
4. Allow foreign direct investment and private enterprises

There were four advantages in the process of China's economic reform. First, communism was a 'foreign' system that China imported from the Soviet Union. Society had been deeply involved with this system only from 1953 to 1978. It would be easier for China to resume the market economy system, which existed before the 1949 revolution. Second, China as we already know has a long history of high civilization. An open market in China occurred several thousand years ago. The commercial activities such as those in the current market economy were common in China's history. These traditions were helpful for China in the transition. Third, the experiences of the successful economic development in the China region such as in Taiwan demonstrated a new road for China's economic reform. Fourth, Hong-Kong, Taiwan, and other overseas Chinese provide mainland China with a vast amount of capital and technology.

CHAPTER III
THE ECONOMIC REFORM POLICY
(1978-2003)

By Nurlia Listiani

III.1. Introduction

China is a remarkable country, not just because of its culture and the world's largest population but also for its success in economic reforms that have been going on for more than 30 years. With a population of 1,292.27 million at the end of 2003, according to the "Statistical Communiqué on National Economy and Social Development in 2003" published by the National Bureau of Statistics, China has imposed population control policies and manageable economic growth, regarding the implementation of a policy of family planning to control population growth which brought the beginning of a decrease in the birth rate. By the end of 2003, the birth rate stood at 12.41 per thousand with the mortality rate at 6.4 per thousand, leaving a natural growth rate of 6.01 per thousand, according to the National Bureau of Statistics (China 2004, p. 54). The current situation is also in line with the administration of economic reforms that started in December 1978 at the Third Plenary Session of the Eleventh National Congress of the Communist Party of China (CPC).

This paper aims to analyze the economic reform policies in China and their effects. First, it will try to explain what is called as economic reform. Second, it will view the form of the economic reform policy. Third, it will describe the application of the market economy as an alternative to Mao Zedong's radical development strategy.

III.2. Brief History of Economic reform in China

When economic development was first initiated in the PRC, it was merely focused on the rural areas and the self-sufficiency principle. For this purpose, Mao Zedong introduced the development model with the construction of the agriculture area as top priority. This caused massive production in the rural areas. Fully labor-intensive methods were used during this process, with the final goal of “socialism”. Although it was highly encouraged, the development of the rural areas didn’t show many good results. The capital used in this process could not be used in the urban areas. For that reason, the development proceeded unevenly. The reason was that this capital was intended to facilitate the rural people to develop themselves and fulfill their own needs. This situation was worsened by the centralized operational system of production units. The state-owned enterprises could not carry out their production freely. The government fully controlled what goods were to be made, at what price they had to be released, and in what quantity they had to be sold. These three market tools did not functioned perfectly with productivity decreasing greatly, while there was no back-up supply of goods from the private enterprises-because they were also highly restricted.

Foreign investment was not forbidden due to the purity of the culture of Chinese leaders that day. So, the state-owned enterprises were highly reliant on the government. The operation mechanism of such enterprises was immobile and stiff with extremely low efficiency. Commercial departments replenished and sold their stocks according to state plans, and the quality, quantity and price of the goods were all fixed by planning departments. This system contributed to stable, planned development of China’s economy, but at the same time limited its development and sapped its vitality.

During the Third Plenary Session of the Eleventh National Congress of the CPC in December 1978, Deng Xiaoping unleashed the initiative to carry out economic reforms. The reforms actually held the basic values of socialism, but not in such a cynical way, with closing to the outside world and held the centralized planning in an extreme position. China’s economic reforms

began first in the rural areas in 1978, when households had a contract with the government to be responsible for the system that was introduced. Under this system, farmers got the right to use the land to plant and to dispose of the agricultural products independently. Farmers had more choices for selling their agricultural products. State monopoly on purchasing and marketing of the agricultural products was abolished; farmer had freedom to decide the prices of the majority of farm products; many policies restricting agricultural development were abolished; and farmers were allowed to engage in diversified business and to set up township enterprises. All these greatly increased agricultural production.

As a result, farmers have been more productive since 1979. Development of new ownership enterprises; collectively owned and individually owned enterprises, and freedom to make decisions and choose the operational procedures brought about tremendous economic growth in the country's industrial output. By 1996, state enterprises accounted for only 28.5% of total gross industrial output value, while collectively owned, individually owned, and other types (including foreign) enterprises accounted for 39.4%, 15.5% and 16.5% respectively (China Statistical Yearbook, 1997, p.411). The open door policy also had a special role in the economic reform process. It encouraged foreign investment and promoted foreign trade. Since economic reform started, there has been a remarkable growth in GDP, with an average of 9.5% per year.

In 1984, the economic restructuring shifted from the rural areas to the cities, and in 1992, due to the establishment of a socialist market economic system, the Chinese government stipulated the main principles for economic structural reform as follows (China, 2004):

- The development of a diversified economy will be encouraged while keeping the public sector of the economy in the dominant position.
- The operations of state owned enterprises should be changed so that they fitted in with the modern enterprise system in order to make the requirements of a market economy.

- A unified and open market system should be established in the country to link the rural and urban markets, and the domestic and international markets.
- The function of managing the economy by the government should be changed to establish a complete macro control system.
- A distribution system should be established based on “work harder get more” to indicate fairness.
- A social security system, suited to China’s situation, for both rural and urban residents should be worked out to promote overall economic development and ensure social stability.

In 1997, the Chinese government stressed that the private sectors of the economy were an important component of the socialist economy of China, in which profitability was encouraged for elements of production, such as capital and technology. Reform in various fields achieved remarkable results in 2002. A socialist market economic system took shape, and the basic role played by the market was improved in the sphere of resource allocation. At the same time, the macro control system continued to get better and better. The pattern in which the public sector of the economy played the main role and coexisted with the private sectors of the economy such as the individually owned economy and the privately owned economy for common development was basically formed along with the restructuring of some government departments (China 2004, p. 96-100).

The reform in the financial sector was also been considered and this is indicated by the willingness of the Central Bank of China (The People’s Bank of China PBC) to restructure the banking system from the mono-banking system to the two-tier banking system. This reform took on the role of the PBC and four specialized banks. Until this time, these changes have had a positive impact on a better role for the banking sector. Although its independence is still not quite clear, the PBC is still making sustainable efforts to better the work of banking.

III.3. Three - Stage Development, Reform Policy and Economic Performance

Since 1978, China's economic reform consisting of many policies aimed at shifting the economic system from the social planned economy to the social market system has resulted in many achievements. The economic reform has been conducted in a gradual strategy rather than "shocking" strategy. This was aimed at making all the people of China understand the meaning of reform as well as its impacts and benefits. Wei (1999) also mentions that the key to manage this reform was macro control with four factors - planning, policy, legislation, administration - that should be taken seriously.

During the reform, China has shown a great many good economic developments with an average GDP growth of 9.4 %, and a controllable inflation rate below 10 % for the past ten years.

Table 3.1.
CPI and Inflation rate (in percentages)
(1985=100)

Consumer Price Index (1985=100)		
Year	CPI	Inflation rate
1985	100	-
1989	160.2	60.20
1990	165.2	3.12
1991	170.8	3.39
1992	181.7	6.38
1993	208.4	14.69
1994	258.6	24.09
1995	302.8	17.09
1996	327.9	8.29
1997	337.1	2.81
1998	334.4	-0.80
1999	329.7	-1.41
2000	331	0.39
2001	333.3	0.69
2002	330.6	-0.81
2003	334.6	1.21

Source: China Statistical Yearbook 2004

Through these 30 years of reform, China has undergone three stages of development: The Initiating stage (1978-1984), The Exploring stage (1984-1991), and the Standardizing stage (1992 - present). The performance of the GDP and some economic aspects will be discussed below.

III.3.1. The Initiating Stage (1978-1984)

The reform took place in State-owned enterprises structure and performances. The government tried to liberalize these enterprises and developed other kinds of ownerships. This was aimed at creating a competitive economic system, since the main goal of this reform was to achieve a socialist market system, allowing these enterprises to compete by themselves. The government intended to push the initiative of state-owned enterprises in production and operation by “delegating power and sharing profits”, so that enterprises would enjoy such expanded autonomy and receive material incentives. By delegating power and sharing profits the enterprises might work out supplementary plans according to the demand in market and arrange the production at its own discretion and sell part of the products (within certain limits) at the price set by the government. This policy was pursued in May 1984, when the State Council confirmed that state-owned enterprises might enjoy autonomy in ten aspects, namely, production and operation programming; product sales; pricing; material procurement; use of funds; disposition of property; structuring; personnel and labour; distribution of wages and bonuses; and the utilization of a combination of power²⁵. This encouraged the collectively owned and individually owned enterprises so that their total investment in fixed assets became 4.6 billion Yuan and 11.9 billion Yuan, respectively in 1980, or increased by 150.4% and 49.8%, respectively, from the year before. In contrast the total investment on fixed assets declined by 10.5%. This condition was followed by a decrease in government revenue to GDP of up to 5.5%. This

²⁵ China. org. cn November 7, 2003

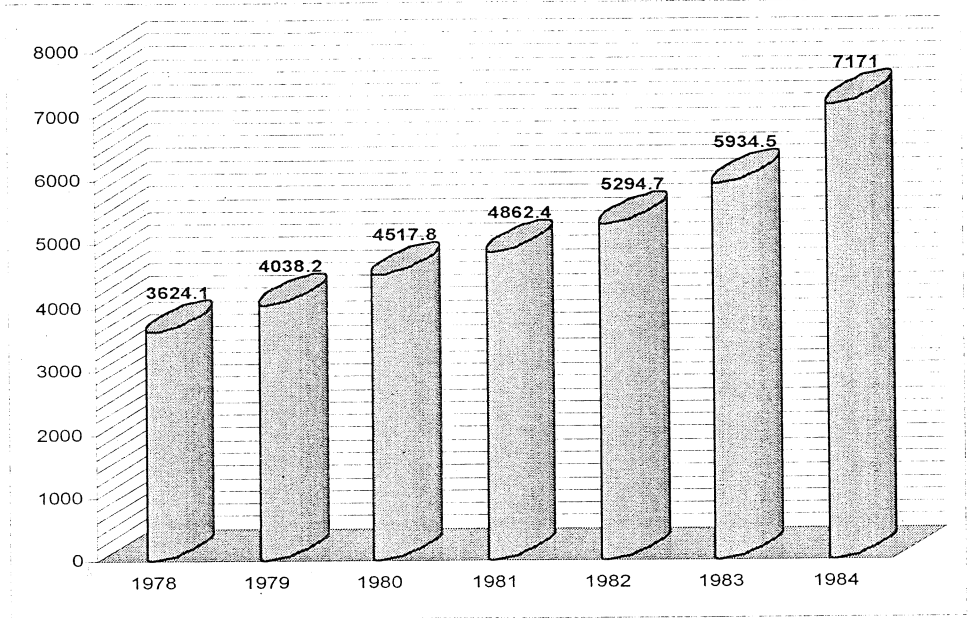
showed the decline of centralisation in the era of decentralisation (China Statistical Year Book, 2004).

In 1980, China applied its “Coastal Development Strategy” and also the Development of Special Economy Zones (SEZs) that was introduced in 1979. In the same year, China began to increase its exports through labour-intensive production. The Open-Trade policy was brought in then. Also in 1980, the exchange rate policy, the “foreign-exchange retention system” (1979) and ISR (Internal Settlement Rate) were put into effect (Fukasaku, 1994). Within this year, the first period of the development of Township enterprises was also introduced. In this period the household contract responsibility system invigorated the rural economy, the factors of production began to flow more smoothly and farmers started to engage in non-agricultural economic pursuits (Shangquan, 1997).

GDP performance indicated signs of increasing, with a burst of output growth supported by agricultural production by these Township enterprises. As shown by Graph 3.1, the GDP growth exceeded 9.1% on average, with per capita GDP growth at 7.83% on average. At the end of this stage, the GDP reached 7171 million Yuan (increasing by 97.87%). Before 1978, China still experienced a negative trade balance, but the GDP started to improve from 1978. The total volume of exports and imports was increased by 11.5 billion Yuan during the period of 1978-1984 (China Statistical Year Book, 2004).

Graph 3.1.

GDP Performance during the First Stage (in 100 million Yuan)

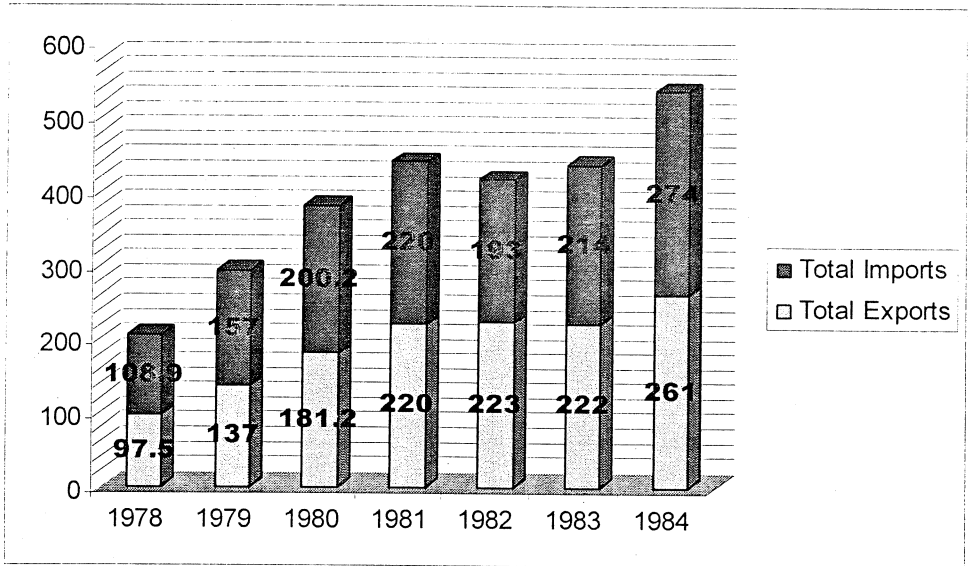


Source: China Statistical Year Book, 2000

The growth average of total exports was 18.78%; the highest growth occurred from 1978-1979 (97.5% in 1978 and 137% in 1979), which shows a great effect on the open door policy. However there was a slight decline of exports (0.45%) from 1982 to 1983. Even though the total import growth 18.04% on average with the highest growth in 1979 and exports 27.52%, but they declined in 1981 to 1982 (12.27%). There was also a zero balance in 1981, but a surplus balance of USD 3 billion in 1982. This was the result of the Coastal development and export-oriented production with labor-intensive strategies. At the end of the stage, the amounts of exports and imports were USD 261 million and USD 274 million, respectively (shown by Graph 3.2).

Graph 3.2.

Total Exports and Imports during the First Stage (in USD 100 million)

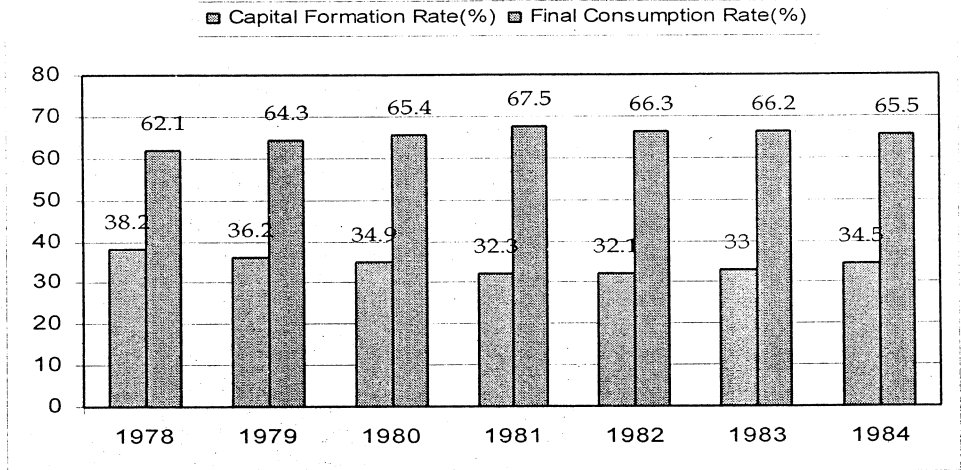


Source: China Statistical Year Book 2004

Graph 3.3 shows that the GDP performance in China, at this stage, was influenced by an increasing final consumption rate, which was always in the range of more than 60%. While the capital formation rate was between 32.1% - 38.2%. This indicated that the economic growth back was boosted by the consumption, not by investment rate.

Graph 3.3.

**Growth of Capital Formation Rate and Final Consumption Rate
During the first stage (in percentages)**

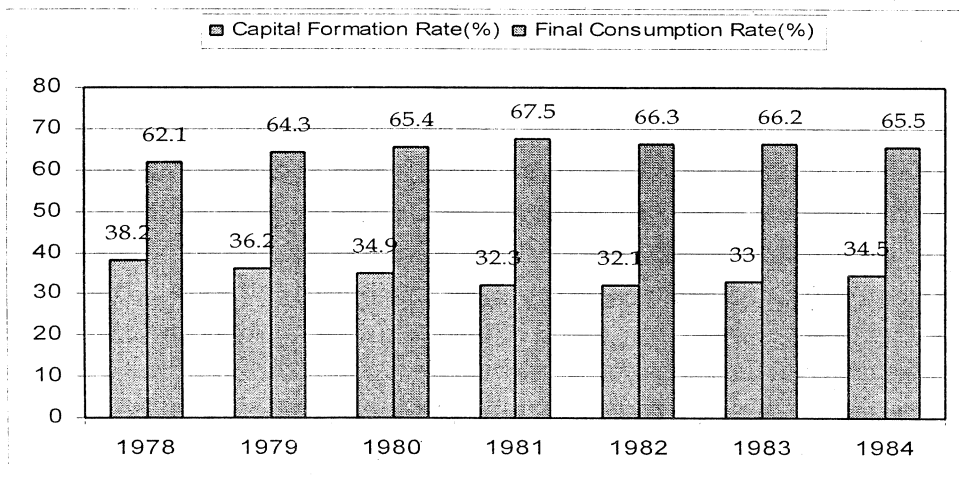


Source: China Statistical Year Book 2004

In the next graph (Graph 3.4), we will see the comparison of the natural growth rate and the economic growth computed from the real GDP with 1978 as the base year and the GDP per capita growth. Overall, the natural growth rate was still above the GDP per capita growth rate and the economic growth. It shows that the economic indicators were not fully achieved, like the condition of full-employment and the ideal proportion between job opportunities and population numbers. It also indicated that the public services were not quite a guarantee to fulfill society's needs. The GDP per capita growth and economic growth even fell by 2.48% and 2.55%, respectively in 1981 while the natural growth rate increased by 2.68%. Even though, the natural growth rate showed a declining trend, the GDP per capita and the economic growth were sharply accelerative.

It means that the economic performance was doing better to bring about a good economic condition. This condition was supported by tight birth control from the government to ensure low natural growth rate.

Graph 3.4.
Per Capita Growth, Natural rate growth, and Economic growth
During the first stage (in percentages)



Source: China Statistical Year Book 2004

III.3.3. The Exploring Stage (1984-1991)

In October 1984, the Third Plenary Meeting of the Twelfth National Congress of the CPC passed the Resolution on Reforming the Economic system, called “the whole people; collectives and individuals to go all out”, and encouraged all sectors of the economy; whether owned by all the people; the collectives or by individuals; or by foreigners; to cooperate with each other by

means of establishing contractual joint-ventures; equity joint-ventures or associations. Small state enterprises were allowed to be “let out” or “contracted” to collectively - or – individually- owned enterprises²⁶.

Yu (1999) claims that there were several obstacles to improving the performance of state-owned enterprises:

- The lack of enterprise independence from administrative entities
- Burden of out-business responsibilities borne by these enterprises
- Distorted price structures, which was quite disturbing, because of several reasons.
- The relatively lower official prices of energy, agricultural products, and transportation compared to industrial products
- One commodity carrying two or more prices; the official price and market price
- Many prices that were used by the enterprises are administrative prices, not market prices

So, in 1984, the government stipulated that:

- Enterprises were authorized to produce and sell in excess of planned amounts
- Enterprises could negotiate with their buyers on the prices of those goods within 20% of the stipulated prices
- Enterprises were authorized to freely dispose of retained profits as production funds, new output development funds, and welfare funds

The lack of development and anticipative policy affected the economy by the first boom of the economy (see Graph 3.7 and the explanation below).

²⁶ China.org.cn, Lok. Cit

Kit Tam (1999) also claims that during this period, the reform of the banking system was initiated.

Before the economic reforms, the People's Bank of China (PBC) was responsible for the execution of the credit plan and the cash plan. To facilitate the process of fiscal reform and associated changes in enterprise finance management, a two-tier banking system was established in 1984 to replace the Soviet-type mono-banking system. With over 80% of the assets of the financial system, the four specialized banks were China's dominant financial institutions—the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, and the Construction Bank of China.

These banks were originally set up to affect the transition from a centralized public enterprise and financial system to a more decentralized and market-oriented one. Each bank was to serve a designated sector or type of transaction, although the demarcation became blurred because specialized banks actively competed for business. The autonomy of the specialized banks was compromised on three fronts. The political pressure from local government and the quantitative restrictions placed by the PBC were the two obvious constraints on bank autonomy. The third factor was the increasing tendency of the Chinese government, at all levels, to insist that banks had to fund prioritized areas or projects. In 1989, these reforms resulted a better financial intermediation performance. Bank Deposits and Loans as percentage of GDP showed good rates, with 63.8% and 84.9%, respectively. The Foreign trade indicated 24.6% as proportion to the GDP in the same year (China Statistical Year Book 2004, p. 36).

In December 1986, the Standing Committee of the Sixth National Congress passed the *Enterprise Bankruptcy Law* (Trial), which stipulates that enterprises in insolvency could apply for bankruptcy. In 1987, the Thirteenth National Congress of the CPC further proposed that the joint-stock system as one of the forms for organizing property might be tried out. The property rights

of small state-owned enterprises might be transferred to collectives or individuals against remuneration²⁷.

Jingwen (1999) says that in September 1987, the Central Committee of the Communist Party of China and the State Council decided to make Hainan Island a province and turned it into the largest special economic zone. Due to this development, the government should play a role in:

- Establishing market regulations.
- Stopping monopolies.
- Solving external problems.
- Solving the problem of blind economic growth.
- Correcting the unfair distribution of income.
- Reducing the losses arising from these subsequent regulations.
- Coordinating the material interests of the states, collectives, enterprises and individuals.

In April 1988, the First Session of the Seventh National People's Congress ratified the *Enterprise Law*. This was the first code law for state-owned enterprises since the founding of the People's Republic of China. This law stipulated 13 items of rights on the basis of generalizing the relevant rules, regulations and policy formulated by the government in an effort to invigorate enterprises following the initiation of the reforms. In addition, the government also released policies, rules and regulations for protecting the private owned sector such as the *Interim Regulations for the Administration of Urban and Rural Individual Industrial and Commercial Businesses*, the *Law of Foreign Invested Enterprises* and the *Provisional Regulations of Private Enterprise*.

²⁷ China.org.cn, Lok. Cit

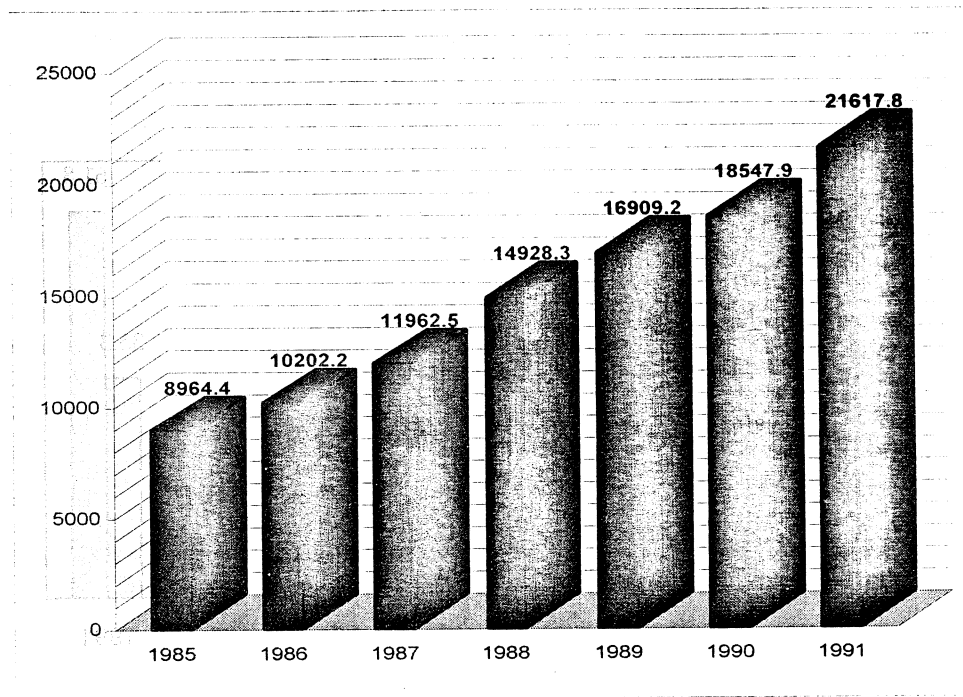
During this period, the most prominent aspect of reforms in state-owned enterprises was the distinguishing of government and enterprise roles, and appropriate separation of the right to own and the right to run (or “the separation of the two rights”)²⁸. Also that year, the government enacted the Law on State-Owned Enterprises, which further broadened their autonomy. This law separated ownership from management. Management of the enterprises was delegated to business managers and enterprises were authorized to carry out production on contract basis. Moreover, the responsibility of the managers was put above that of the party representatives²⁹. However, the implementation of this policy indicated not very good economic performance, with the occurrence of the second boom in 1988 (Graph 3.7 and the explanation below).

The second and the third periods of the development of Township enterprises were also in this term, when there were fluctuations in agricultural production. However, the township enterprises flourished, the rural economy enjoyed comprehensive development and the farmers’ incomes soared (Shangquan, 1997).

²⁸ China.org.cn, Lok. Cit

²⁹ China.org.cn, Lok. Cit

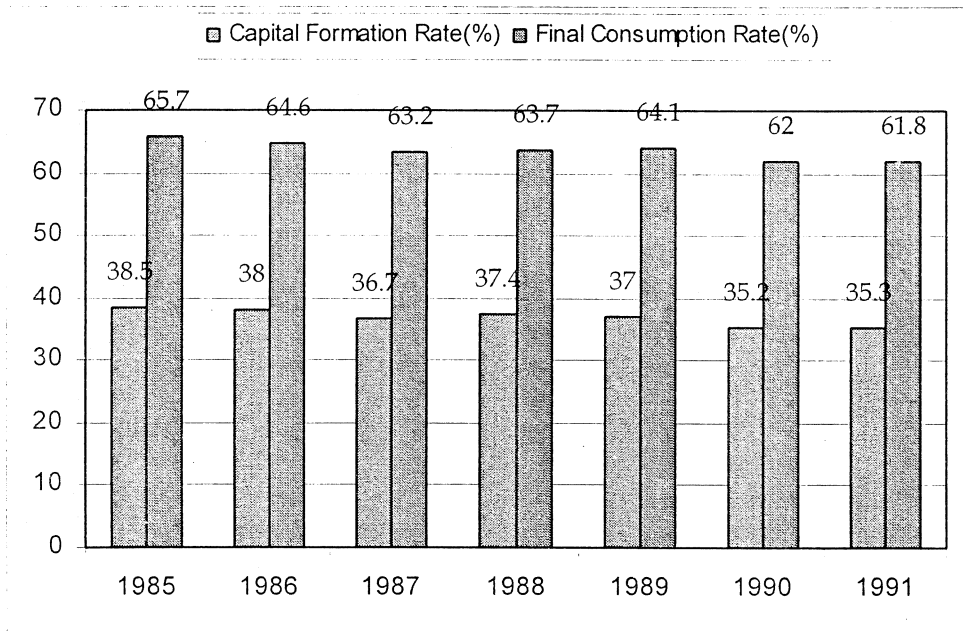
Graph 3.5.
GDP Performance
During the Second Stage (in 100 million Yuan)



Source: China Statistical Year Book 2004

The GDP growth during this period was 9.68% on average and per capita GDP growth was 8.68% on average. In short, during this period the average of both the GDP growth and the per capita GDP increased. At the end of this period, the GDP sharply increasing from 2161.7 billion Yuan at the beginning of this stage from 896.4 billion Yuan (Graph 3.5). However, this accelerated GDP performance was boosted by the still relatively stable consumptive sector with over 60% of percentage of the GDP by expenditure (Graph 3.6).

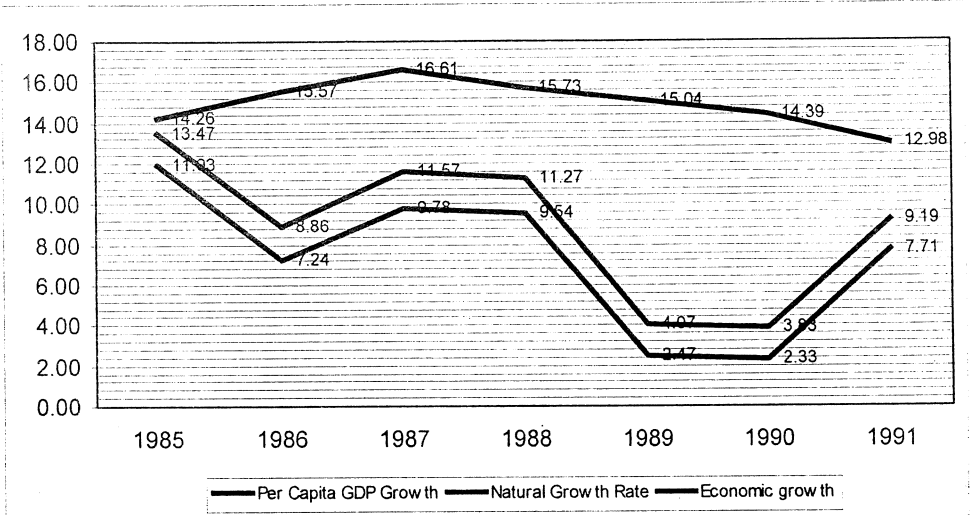
Graph 3.6.
Capital Formation rate and Final Consumption rate
During the second stage (in percentages)



Source: China Statistical Year Book 2004

Graph 3.7, depicts a comparison of the natural growth rate, the economic growth rate and the GDP per capita growth rate. It seemed that the stable-declining natural growth rate still could not be matched by an unstable GDP per capita growth rate and economic growth rate, both of which shown.

Graph 3.7.
Per Capita Growth, Natural Growth rate, and Economic growth
(in percentages)

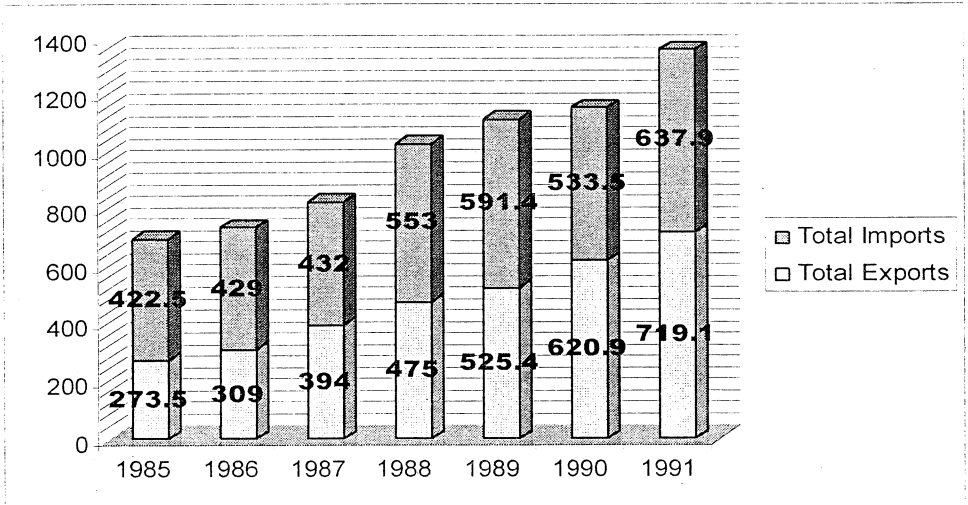


Source: *China Statistical Year Book 2004*

This stage (1984-1991) experienced the first and the second boom of economic cycles. The first one was in 1984. There was a corresponding lag between the rise of income and price levels as cost of living inflation that in 1984 held at 4%. But in 1985, inflation rose to 12.5%. An anti-inflationary policy was adopted dampening the growth of income and price levels in 1986 to about 8% and 6% respectively. The second boom, in 1988, was characterized by a higher inflation, 20%, triggered by the income growth of 11%. This triggered a round of panic buying and hoarding in some cities. A forced re-trenchment policy with controls on credit and imports briefly brought the economy to a near standstill as prices and income both plummeted. Fortunately, this slowdown was temporary (Soon, 1999). These two conditions can be seen above.

In 1990, the economy crawled back and recovered slowly but surely, which raised the GDP per capita growth and economic growth rate to 7.71% and 9.19%, respectively, while the natural growth rate was 12.88%, in 1991. The natural growth rate was still above the GDP per capita growth rate and economic growth rate. For the stable-declining natural growth rate, thanks were due to the tight government control on the birth rate.

Graph 3.8.
Total Exports and Imports
During the second stage (in USD 100 million)



Source: *China Statistical Year Book 2004*

The average growth of total exports in this stage was 15.78% while that of total import was 14.45%. At this stage, the export growth had exceeded the import growth, which indicates a positive trade balance. The export volume started to pass the import volume in 1990, due to the good economic performance, as China, according to Fukusaku (1994) was the leading fast-growing developing country in the Asia-Pacific region in the 1990s. This con-

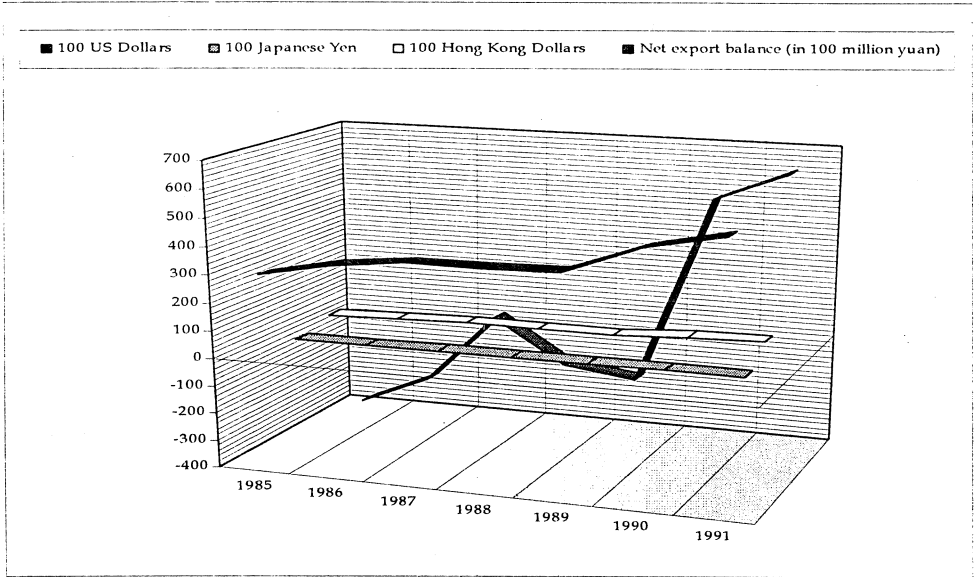
dition strengthened in 1991, when there were new forms of trade, processing trade, compensation trade, and barter trade. Textiles, clothing, footwear, watches, and simple electrical products accounted for at least one third of China's exports. Meanwhile, Guangdong was the most important location for foreign investment in joint ventures under-processing-and-compensation trade agreements, with investors mainly from Hong Kong.

In the same year, Shenzhen was leading the development of SEZs and the development of SEZs was eventually successful. There are three reasons about this:

1. There were substantial taxes for Chinese enterprises
2. There was easier access to duty-free imports, free of most controls
3. Firms in SEZs had more freedom in planning controls than firms elsewhere.

This situation impacted on the stability of the average exchange rate, which showed a stable performance against US Dollars, Hong Kong dollars, and Japanese Yen. This is shown by Graph 3.9.

Graph 3.9.
Average Exchange Rate
During the second stage (in percentages)

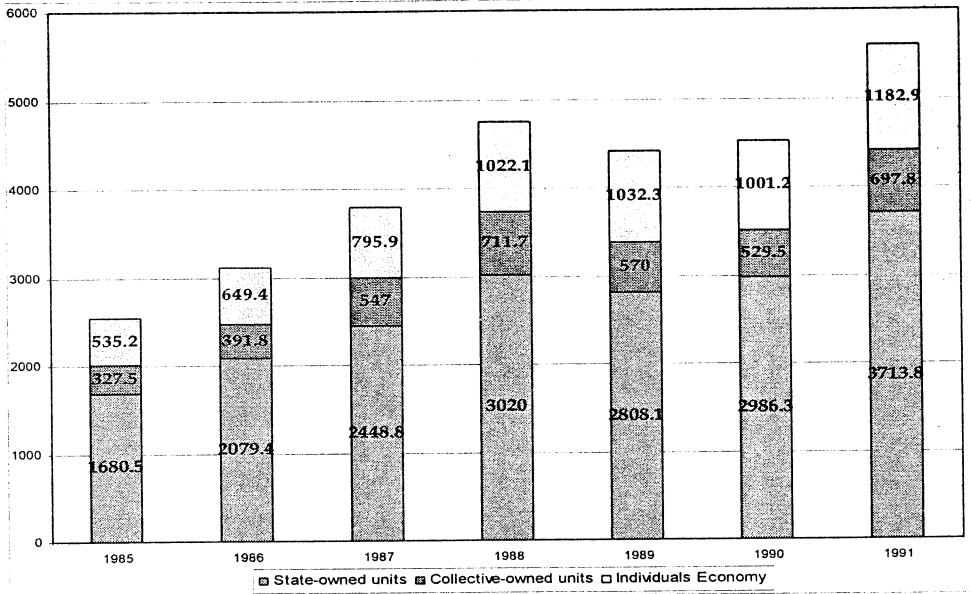


Source: *China Statistical Year Book 2004*

Meanwhile, in the development of enterprises, the state-owned enterprises' growth was slowing down—with an average growth rate in investments on fixed assets of 18.61%, whereas the collective-owned ones were growing rapidly—with an average growth rate of 18.74%, and the individually-owned ones had an average growth rate of 17.04%. The total investments in fixed assets were rising since 1985 and gained its peak in 1988 due to the economic booms. Then declined for temporary, but rose again in 1990 due to a better economic performance as shown by the two graphs above. This situation can be seen in graph 3.10.

Graph 3.10.

**Total Investments on Fixed Assets by Ownership
During the Second Stage (in 100 million Yuan)**



Source: China Statistical Year Book 2004

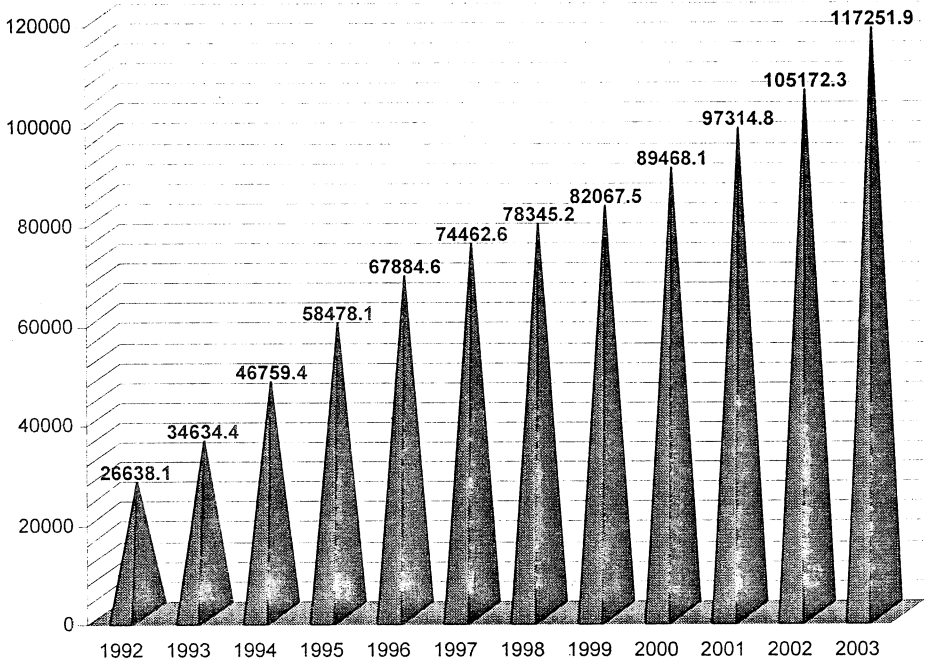
By 1990, the total investment in fixed assets was over 45 billion Yuan. At the end of this stage, the individually-owned enterprises were increasing and the state-owned ones were crawling out again to dominate the economy. This was shown by a total of 118.2 billion Yuan of individually-owned enterprises investment and 371.3 billion Yuan of state-owned enterprises investment. This total investment in fixed assets increased after the two development stages, with an average of 41.04 billion Yuan (China Statistical Year Book, 2004). This resulted in a better development of the enterprises, but the state-owned ones still ruled the economy, and the government revenue's percentage to the GDP declined from 22.4% in 1985 to 14.6% in 1991.

III.3.3.The Standardizing Stage (1992 - 2003)

The GDP performance (11725.19 billion Yuan in 2003) showed good signs, at least better than the Second Stage. The average growth rate was 9.7 % annually. Every year, the economic growth was also quite stable at around 10%. Meanwhile the growth average for the GDP per capita growth was 8.75% annually. Overall, the economic performance at this stage was increasing steadily (Graph 3.16). The GDP can be seen in Graph 3.11. Graph 3.12 shows that the investment started to play an important role in the GDP, with an increasing proportion of the GDP by expenditure of around 40%, better than at the last stage when it was only 30%. This shows that the GDP was boosted not only by consumption, but also by the capital formation rate. This condition was supported by the more fundamental role that the foreign investments took at this stage as will be discussed below.

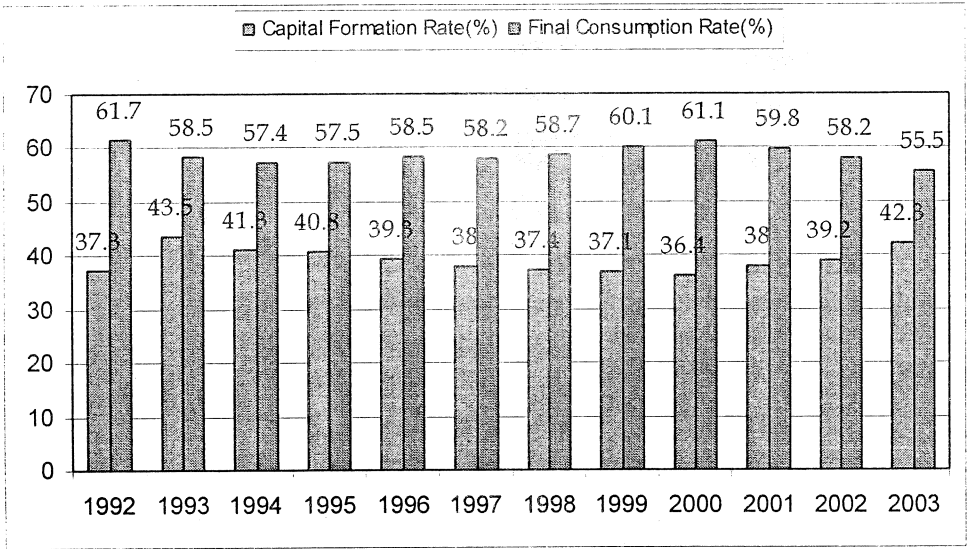
Graph 3.11.

GDP performance during the third stage (in 100 million Yuan)



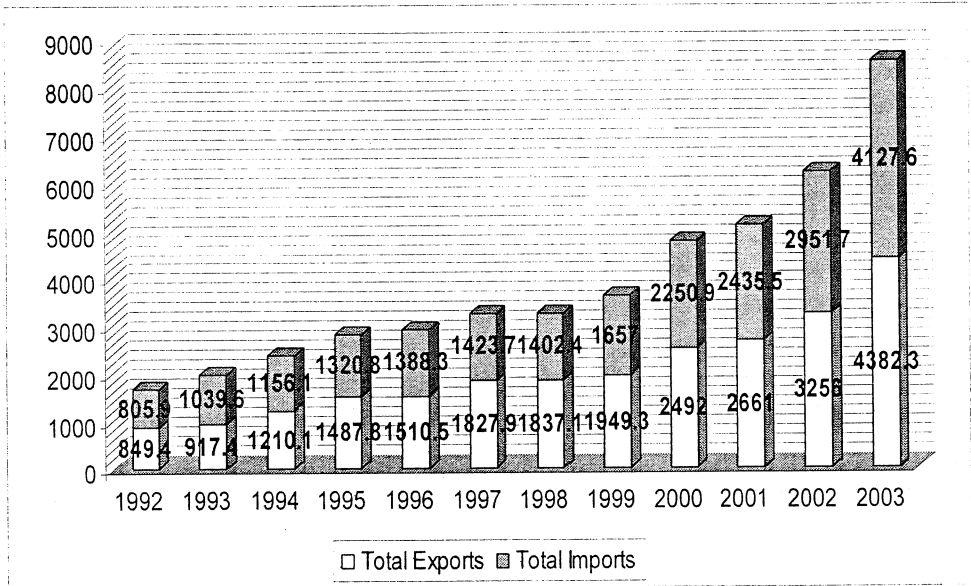
Source: China Statistical Year Book 2004

Graph 3.12.
Capital Formation Rate and Final Consumption Rate
During the third stage (in percentages)



Source: China Statistical Year Book 2004

Graph 3.13.
Total Exports and Imports
During the third stage (in USD 100 million)



Source: China Statistical Year Book 2004

The proportion of total exports and imports of the GDP increased sharply. In 1978 it was 9.8%; 1989 - 24.6%; 1997 - 36.2%; and 2003 - 60.1% (China Statistical Year Book, 2004). This was supported by the export volumes that exceeded the import volumes of the Second Stage. This condition created positive net balances that ensured stability of the flow of goods and currency values. The FDI in utilization of foreign capital had average annual growth rate (1990 to 2003) of 21.8%, while other kinds of foreign investments were 14.8% (China Statistical Year Book, 2004).

The reform was still run by the modernisation and effectiveness on state-owned enterprises. The policies taken were still focussed on them. In July 1992, the State Council issued and enforced the *Rules for Shifting the Operational Mechanism of the Industrial Enterprises Owned by the Whole People*, in which the basis of the 13 rights, was stipulated in the Enterprise Law, but furthermore the enterprises were entitled to 14 rights: i.e. decision-making in production and operation, price-setting for products and labour, selling of products, material purchase, import and export, investment decisions, disposition of retained bonuses, disposition of property, decision on joint operations or mergers, labour employment, personnel management, distribution of wages and bonuses, internal structuring, and refusing apportioning.

Hence, enterprises would become commodity producers and business operators that had the ability to adjust themselves to the requirements of the market; that was operating independently according to law and responsible for their own losses and profits; and were capable of developing on their own and were self-disciplined³⁰. These policies encouraged enterprises to develop in such a competitive environment aimed at the social market mechanism. Compared with the previous year, the total proportion of total fixed assets investment composition changed. The state-owned enterprises increase to 68.05% from 66.38%, while collectively-owned enterprises increase by 16.82% and individually-owned ones by 15.12% (Graph 3.14). This stage was also the final period of the development of Township enterprises, along with Deng Xiaoping's speech on his tour to South in 1992 (Shangquan, 1997).

In October 1993, the Fourteenth National Congress of the CPC made it explicit that the objective of China's economic reforms was to establish a system of socialist market economy. State-owned enterprises, collectively owned enterprises and other types of enterprises were all requested to enter the market, and to compete in the market so that only the fittest would survive.

³⁰ China.org.cn, Lok. Cit

In November 1993, the Third Plenary Session of the Fourteenth National Congress of the CPC passed the *Decision on Several Issues for Establishing a Socialist Market Economic system by the Central Committee of the CPC*, which stated that the “market was to play a fundamental role concerning the resources under the macro control by the State”, that “the State was to create the conditions for all sectors of the economy to participate in the market competition on an equal footing, and enterprises from all sectors would be treated indiscriminately”. State-owned enterprises were to fit in with the requirements of a market economic system in establishing a modern enterprise system with “clearly established ownership, well defined power and responsibility, separation of enterprises for administration and scientific management”³¹.

This policy also changed the enterprises’ development structure because other kinds of enterprises – e.g. foreign invested enterprises – became newcomers that made the market more competitive. This was proven by the composition of total fixed asset investment in state-owned enterprises that declined to 60.63%, collectively-owned enterprises increased to 17.73%, individually-owned enterprises declined to 11.29%, and the other types of ownership held by 10.35% (Graph 3.14).

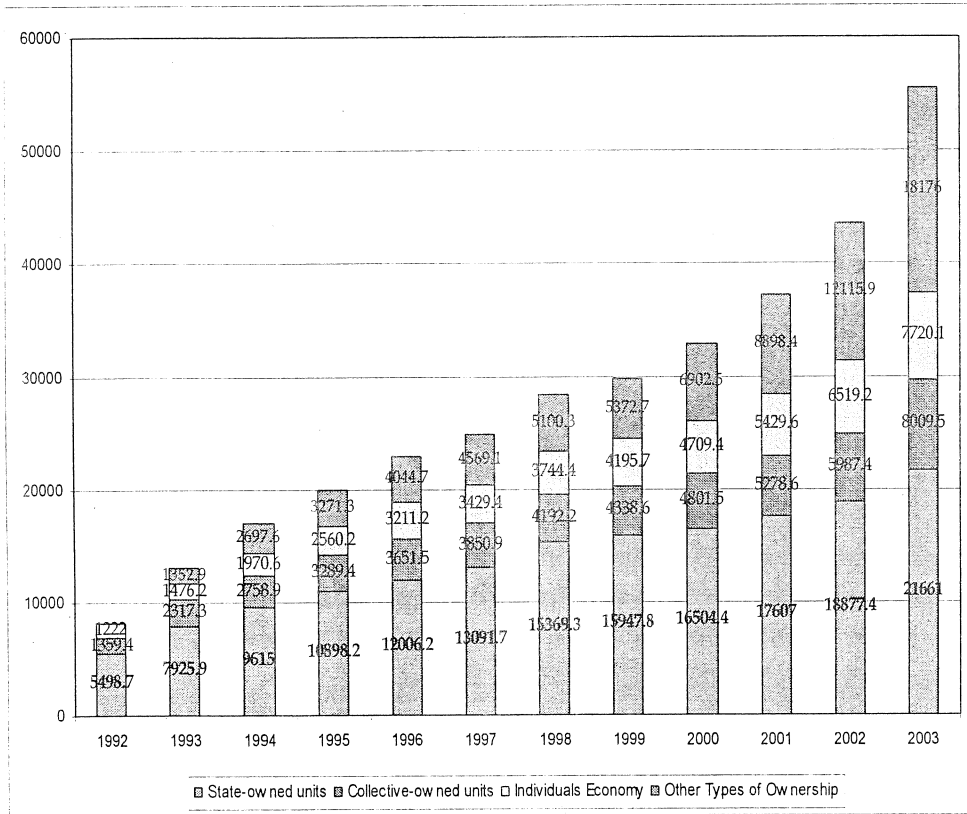
In December of the same year, the Standing Committee of the National People’s Congress passed the *Company Law*, which stated that companies funded by investing bodies of different ownerships were all equal by law. In 1997, the Fifteenth National Congress of the CPC further stated that “the private sector is an important component of this country’s socialist market economy, and the statement was incorporated into the Constitution amended in 1999³².

³¹ China.org.cn, Lok. Cit

³² China.org.cn, Lok. Cit

Graph 3.14.

**Total Investments on Fixed Assets by Ownership
During the Third Stage (in 100 Million Yuan)**



Source: China Statistical Year Book 2004

In November 1994 the State Council selected 100 large state-owned enterprises for trial implementation of the modern enterprise system, staging the prelude for the transformation of system on a large scale among state-owned enterprises. In the large state-owned enterprises undergoing trial transformation, investing institutions or government departments authorized by the State or other investors were entitled to shareholders' rights in proportion to the shares held. The contributors were not allowed to withdraw the funds, but the enterprise property may be legally transferred.

In respect of the financial and accounting systems, the *General Principles of Business Finance and the Accounting Standard for Enterprises* that were basically in consistence with the international standard were implemented throughout the country. This was meant to back-up the development of the new modern enterprise system, along with the enterprises' management-form transformation³³. At the end, in 2003, the composition was a shock, noted by other types of ownership enterprise share of total fixed asset investment by 32.71%, second after state-owned enterprises (38.98%), collectively-owned enterprises (14.41%), and the last was individually-owned enterprises with 13.89%.

This meant that the other types of ownership enterprises had increased their proportion by 22.36% since they came in to the competition, better than state-owned and collective-owned ones, which decreased by 21.65% and 3.31%, respectively, than in 1993 (Graph 3.14). This condition was also supported by other policies and events in the following year, such as:

- In September 1999, the Fourth Plenary Session of the Fifteenth National Congress of the CPC passed the Decisions of the Central Committee of the CPC on Several Important Issues in the Transformation and Development of state-owned enterprises, stating that the stock rights of state-owned enterprises were to be diversified and that companies with diversified in-

³³ China.org.cn, Lok. Cit

vesting bodies were encouraged in order that they be turned into companies with a standardized procedure³⁴.

- In April 2001, the State Economy and Trade Commission, the Ministry of Personnel and the Ministry of Labour and Social Security jointly issued the *Opinions on Deepening the Reforms of the Internal Personnel, Labour and Distribution Systems of state-owned enterprises*, stating that the administrative ranks in enterprises were cancelled, the managers were no longer entitled to treatment according to their administrative ranks exclusive to government officials. All the managers, except those to be controlled by the fund contributor or those to be elected or replaced according to statutory procedures, were to be employed from the survivors of open election contests, or to be recruited from throughout the society³⁵.
- This stage of the reform featured the establishment of a modern enterprise system (with the joint-stock system being the priority option) in the development of the state-owned enterprises. During this period, regulations and laws including the *Opinions on Standardizing the Joint Stock Limited Companies*, the *Provisional Regulations on the Administration of Issuing and Trading of Stocks*, the *Securities Law of the People's Republic of China* and the *Criterion Governing the Listing Companies* were successfully issued, forming an important guarantee for the standardized operation of the listed companies³⁶.

As for in the financial sector, there seemed to be a lot of consideration. Although China passed a 1995 banking law that gave banks full autonomy, government influence remained very strong. Nevertheless, the Chinese government decided to continue the efforts to make most Chinese banks independent and to become truly commercial banks. In addition, the success of China's economic development also depended upon the opening up of its financial

³⁴ China.org.cn, Lok. Cit

³⁵ China.org.cn, Lok. Cit

³⁶ China.org.cn, Lok. Cit

market to foreign banks. As more foreign companies in China demanded financial services from foreign banks, and more importantly, as China needed to open its financial market in order to enter the World Trade Organization (WTO), the Chinese government had to make greater efforts to open up its financial service sector. In 1996, it cut foreign firms' value-added tax rebate for exports from 17% to 9%. It also planned to withdraw the privilege enjoyed by FIEs to import capital equipment tax and duty free, although the government had recently modified this plan.

In 1997, the State Planning Commission issued a foreign investment guideline, which indicated that China needed to monitor the impact of foreign investment on the country's economy security³⁷. As a result of achievements in financial intermediation, China has a 23.2% average growth rate of Deposits of the National banking system, and a 19.5% average growth rate of Loans of the National banking system from 1978 to 2003. Also, the Bank Deposits as percentage of the GDP had increased sharply since 1978, with 31.3%, and in 1997, with 110.6%. In 2003, it had become 177.4%. Bank Loans as a percentage of the GDP also increased sharply, since 1978 (51%), then in 1997 (11.6%) until 2003 with 135.6%. This showed a good function of financial intermediation (China Statistical Year Book , 2004, p.28).

Somehow, however, at this stage, problems arose. Gouging (1999) says that investment in fixed assets expanded on too large a scale and the infrastructure facilities were apparently inadequate to support the economic development. The financial sector also faced some disorder, with too much currency being issued and widespread irregularities in inter-bank loans and unauthorized funds collection. Real estate, development zones, stock and securities became overheated while a large amount of funds was idle.

³⁷ China.org.cn, Lok. Cit

Yu (1999) also makes several points:

- ▣ The rapid growth of private enterprises has resulted in a large income discrepancy between employees of the government and those of private enterprises.
- ▣ The decline of state-owned enterprises has gradually reduced economic centralization.
- ▣ Unbalanced regional development could result in many socio economic problems.
- ▣ Not all state-owned should be privatized.
- ▣ Inflation is an inevitable result when a country transforms from a centrally planned to a market economy.

This worsening condition was caused by the GDP discrepancy between western provinces and north-eastern provinces, with the National GDP percentage of 16.9% and 9.6%, respectively, in 2003.

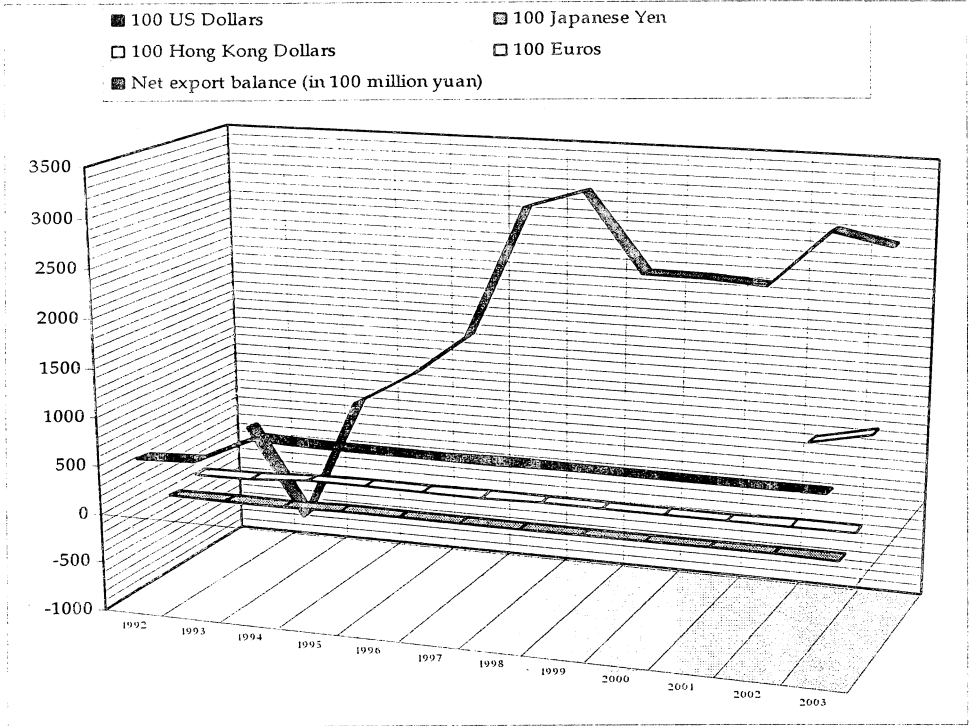
In terms of fiscal policy, the Chinese government encouraged a proactive fiscal policy, exclusively in taxation. In foreign trade, the entry of China into the WTO forced them to distinguish some of their policies, such as Import licensing and Service licensing. On monetary policy, the Chinese government, as Ruogu (2002) claims, tried to manage these objectives:

- ▣ Use monetary policy instruments in a flexible manner to adjust the money supply appropriately and maintain reasonable growth in credit aggregates;
- ▣ Promote the reform of the interest rate mechanism, and bring interest rates into full play in adjustment of the demand and supply of funds, as well as in the optimization of resource allocation;
- ▣ Improve the incentives applying to lending and corporate governance of commercial banks;
- ▣ And improve the RMB exchange rate formation system under the precondition of preserving the stability of the RMB exchange rate.

Importantly, the Chinese government also implemented the protection of *Property Rights*, *Worker's Rights*, etc. just to ensure the marketing process. On the exchange rate policy, for these past years, China used the “manage float” exchange rate. But, this year, they turned to “fixed rate” Policy, to protect domestic conditions from greater damage caused by currency shocks. The first reform in exchange rate policy was in 1979, with introduction of a foreign exchange retention system. The ISR (Internal Settlement Rate) was put in place in 1980 (Fukasaku, 1994). With this step, it seemed the people of China had proved themselves to have a strong and well-established financial sector. During this stage until 2003, the exchange rate movement was relatively stable in US Dollars also in Hong Kong Dollars and Japanese Yen (Graph 3.15)

Graph 3.15.

**Average Exchange Rate Compared to US Dollars, Hong Kong Dollars,
and Japanese Yen
During the Third Stage**



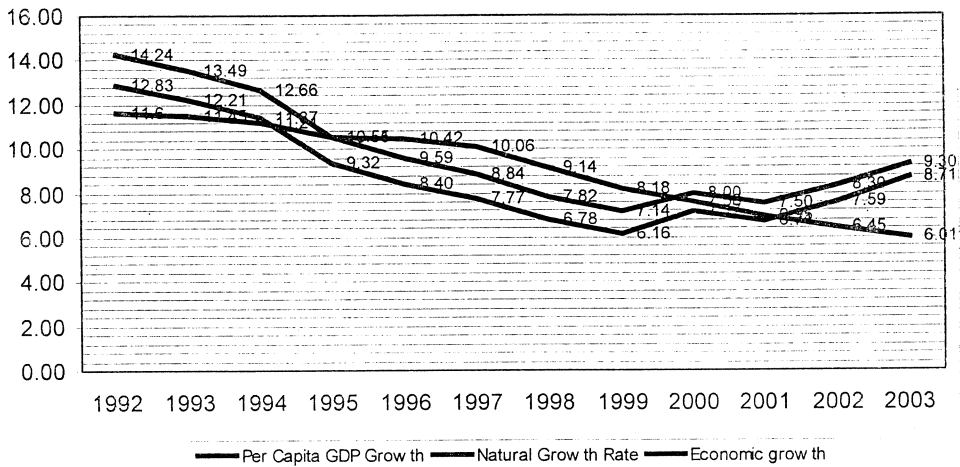
Source: *China Statistical Year Book 2004*

A comparison of the natural growth rate, the economic growth rate, and the GDP per capita growth rate, is shown in Graph 3.16. Finally the economic growth rate and the GDP per capita growth rate could match the natural growth rate, which means that the better economic development condition could be in keeping with a controlled birth rate, so that the employment oppor-

tunities and minimum living standards could be upheld. The unemployment rate registered in the urban sector, was only 7 million and 8 million people in 2002 and 2003, respectively. While the employment rate, which was over 7 billion people in those two years, far exceeded that number (China Statistical Year Book, 2004).

Graph 3.16.

The Natural Growth Rate, GDP per Capita Growth Rate, and Economic Growth During the Third stage (in percentages)



Source: China Statistical Year Book 2004

III.4. Reforms and Policy making through the market system

In the application of economic reform, the Chinese government tried to employ a “step-by-step” strategy rather than the “shocking” strategy such as massive privatization or high rate of saving to conduct the capital formation, because although slower than the “shocking” strategy, it would give a

better result. The aim of this process was for the Chinese people to try, to learn and adapt to this reform, since knowledge cannot be simply imposed on all classes of the society, especially regarding the gap between the rural and the urban areas.

Reform was first implemented in the rural areas, and then gradually carried to the cities; it was first tried in the special economic zones, then in the coastal areas, then finally in the interior. The market mechanism was first introduced into the rural industrial enterprises, privately operated enterprises, foreign-invested enterprises, and then gradually to the state-owned economy. Reform was first carried out in a small way, such as granting state-owned enterprises more autonomy in production and operation. Then it was conducted on a larger scale by gradually reforming the planned economy and the fiscal and financial systems. This method pushed the economic reform in a gradual way, as the creation of the Chinese people. It is also a result of their persistent search in practice.

This application was also implemented in price reform. Price reform is taken seriously because price is one of the most valuable tools for the market economy. Without the "market-movement" of price, there would be no equilibrium for supply and demand of a market commodity or whole goods and services in the one country. Price also can bring the market economy into a full mechanism, which will bring full-employment and the perfect mobilization of resources, according to the Classical way.

The Chinese government understands well that reforming the price mechanism is not easy. It will require good understanding from all the players in the market, and a long-term mind-concept, so that any disturbances to the economy in the short-run will not be carried out by a panic of the market players. Instead, hopefully they will continue to be optimistic about the market because any rushed action through this kind of situation will just bring greater damage to the economy in the long run, although it will give greater benefit initially. At least this is what Lucas' critique claims and was experienced by many developing countries. Full-control of price by the government

will cause higher inflation, because the government will always suffer from the burden caused by the failure mechanism of the market.

For that reason also, price reform will need a strong financial system to back-up the optimistic expectations of the market players. Although price reform can be made in a short time, the market adjustment for these changes will have long term effects. So the financial system, which is considered the intermediary, should have an important role in maintaining the market level at its best. In this case, Chinese government has adopted a positive and prudent price reform policy, under which price control on commodities in different sectors was lifted at different times.

In short, as Shangquan (1999) claims there are several reasons why reform should be a gradual strategy:

- Reform needs time to win the understanding and support from all the Chinese people, so it should be gradual. Though people will benefit from the reform, still the interests and power of some people will inevitably have to be adjusted to a certain extent. Therefore reform needs time to win the understanding and support from the society. This is especially true for reform measures involving the adjustment of the people's interests. Therefore, such reform measures, before being fully carried out, must first be experimented with and gradually accepted by the people. Only when people understand these measures can they support them. Otherwise, it may endanger the previous results.
- The adoption of this strategy has something to do with the economic system itself. The economic system is complex, we must know the point we should target first; always the weakest point of all. In this case, the strongest point is the state-owned sector, but it is hard for it to be changed and would take some time. Restructuring the external environment, the non-state-owned sector has to create a much more competitive environment to force the state-owned sector to improve itself at any cost.

- Finally, the political culture of a country always affects the country's economic performance and achieving a stable political condition is hard work. That is why such a shock for the economy cannot be implemented because it will cause a big losses in political expectations.

One of the main goals of this economic reform was to implement a social market system, which was difficult through the marketing process. Gao also mentioned some reasonable steps to build the mainframes of this system, which are:

- Establish a modern enterprise system in which the property rights of enterprises are clearly defined, and enterprises have operational autonomy and are themselves responsible for gains and losses, and competition among them is based on fair basis. Various kinds of ownership enterprises could be introduced, because they can promise the heterogeneity of commodities. Also uphold the law, because a competitive culture should be guaranteed by restricted rules to uphold fairness. The property rights and autonomy to produce and make decisions should be supported especially in state-owned enterprises.
- Establish a modern market system with sound market regulations, complete organizations, and standardized market behavior. Price control on the vast majority of commodities and production factors needs to be lifted to establish a level of equilibrium at the market level. A unified and open market should be established, to encourage market clearance and flow of goods that will provide foreign trade and connection between domestic market and international market. Also the restructuring of government infrastructure and a smaller role for the government in the economic system should be realized. Monetary and fiscal policy should back-up each other to support output growth. That is why there should be a clearer task division between government and the central bank, which should be given independence to control the monetary system. The forming of market clearing level should also be determined by these:

- o Free entry/exit in all markets.
- o Equal access to economic information for all.
- o Rational decision making by all agents.
- o Absence of monopolistic/monophony power.
- o Absence of natural disturbances, such as natural disaster, etc.
- o Full employment of people and resources.

So, all kinds of policies should support those objectives to ensure market creation.

III.5. The Idea of Socialist Market System

Many economists argued that there could not be a socialist market system, because it has two very different strands. Socialist is related to restricted production units, the enterprises that are not allowed to sell and produce goods freely. It is all about central planning of the market system. At least this is what Mao tried. On the other hand, developing a high competitive market, where everyone can taste his/her own decision-making, including gains and losses, is what a capitalist or market economy is focused on.

The basic difference between these two fundamental economic systems is the freedom to make decisions, and take on the burden of any policy failure. A socialist's government will suffer a great burden from their failure in production and at the market stage. This would be caused by their risk in centralizing the decision making, including the gains and losses. In the market economy, whoever makes gains, earns respect and whoever makes losses must cope with the losses.

The most common idea in combining the market economy and the socialist economy is to privatize the state-owned sector massively. The government usually sells the industry to the private sector, often, the foreign buyer.

Of course this will cause the government to earn a very small percentage of the GDP and that would be a tragic loss.

For China, this is considered the “shocking” strategy and must be avoided. What the Chinese government tried to do was restructure the ownership by freeing the decision-making and production process with the enterprise still owned by the government. On the other hand, the government developed many other ownership enterprises, such as township, collective, up to foreign-invested ones. This may not directly affect the state-owned sector, but it would force them to face the risk from losing in competition.

This was considered to be “external” reform for the state-owned enterprises. For the “internal” reform, there was the reform of the government infrastructure, meant to get rid of the non-potential government agent out of the way. In the end, these two changes would be the optimal point for the state-owned enterprises’ position in the market economy. With this effort, they would be responsible for their own fate and compete with the private and foreign sectors to increase the quality of the enterprises’ mechanism.

Nevertheless, to enter the market clearing level, there were some transition procedures and criteria to be upheld. Klein (1999) says that the criteria are all considered to add to macroeconomic stability, which consists of:

- Restraining inflation-preferably kept well under 10%;
- Maintaining a high-level of employment;
- Maintaining a strong output growth;
- Keeping the income/wealth distribution equitable;
- Providing basic social services for the population;
- Building up the country’s infrastructure;
- Keeping the balance of international payments near equilibrium (current account near zero);
- Keeping the internal fiscal balance near zero;
- Keeping the money supply under control;

Those are quite ideal specifications, but it is certain that those specifications would be hard to accomplish. However, China has had its process of marketing, as was said before, without putting the economy into the major recession. These were the procedures, according to Klein, that China went through:

- The goal has been a mixed economy, with some private ownership, in other words, market socialism
 - As discussed above, market socialism in China was about restructuring the decision-making, production and operations. This would ensure the market competitiveness and fairness.
- Implementation of openness for trade and technology
 - To reform and catch up with the high economic growth, it would cost the rapid output growth. This is where high technology and more capital intensity were needed. Foreign trade and openness ensured it, also the capital flow.
- Creation of special economy zones (SEZs)
 - Openness would be attractive if there were tariff concessions, subsidies, special rights in protected areas, and by furnishing ample resources for transportation, telecommunication, and other essential business elements. These special economic zones provided those facilities, also inexpensive labor and raw materials.
- Sequencing of economic reform prior to political reform;
 - It is true that political conditions and economic performance would always go together. So it was necessary to stabilize the political condition to ensure the expectations of both the domestic and the foreign sides. This is what the gradual strategy meant.

- Introduction of modern economy education;
 - Many modern economic ideas were developed and very helpful to the strategic policy of the government.
- Gradual geographic distribution of economic gains;
 - Urban centers, ports, and financial centers had to be liberalized first as the Chinese government did. This was a crucial step because the liberalization took place where modernization came in. With open-minds and knowledge, this process played an important role in making the people of China become rational and understand the reforms.
- The absorption of quantitative methods from econometrics and statistics in preparation for application to economic planning;
 - The fund of quantitative methods in China was meager in 1979. The gradual buildup of time-series samples, cross-section surveys, special indicators and many other information systems were vital for intelligent economic planning.

III.6. Conclusion and Suggestions

China has made great efforts in establish a market system and decentralisation. This system made gradual reforms and it was the best way under Chinese conditions, with such a large number of citizens and many regions that should be taken care of. The implementation of free decision-making has taken the economy to creativity of production and a market clearing level. Economic reform in China has been going for about 30 years, and it is still showing improvements; shown by the increasing GDP growth, stable inflation rate, and other indicators.

The first aim of these reforms; the social market system, is getting closer. We can see that the development of the other ownership enterprises has overlapped with the development of the state-owned enterprises. This should be taken seriously, because it might go to the wrong way. Instead of an

established competitive market, we could see the establishment of a monopolistic system, but this time by the foreigners.

There are many other potential problems. The awareness of decentralisation should be prioritized. The lack of income distribution could cause some serious problem, although there have been the “project to send electricity from the west to the east”, the “project to transmit natural gas from the west to the east”, and the “project to divert water from the south to the north” on the run. In response to the critical urbanization problems, there should be development of the small towns, so the labour force is not designated only to the cities, but to help to develop less-advanced regions.

The financial sector should be more strengthened, because it will guarantee good intermediaries for the economy especially in monetary conditions. As the monetary authority, the independent role of the PBC should be emphasized more.

There are several suggestions that Professor Lin's³⁸ main recommendations for solving the problem of China's State-Owned Enterprises are:

³⁸ Justin Yifun Lin (Ph.D., University of Chicago, 1986) is the founder and director of the China Center for Economy Research at Peking University www.ccer.pku.edu.cn/ and professor of economics at Hong Kong University of Science and Technology. Professor Lin is the author of eight books, including the *China Miracle: Development Strategy and Economic reform*, which has been published in seven languages, and the *State-owned Enterprise Reform*, which is available in Chinese, Japanese, and English. He has published more than 100 articles in refereed international journals and collected volumes on history, development, and transition. Among many of his public roles in China, Justin Yifu Lin was a senior advisor to the Drafting Committee of China's Tenth Five-year Plan, an advisor to the mayors of Beijing, Shanghai and Tianjin, and a member of the National Committee, China People's Political Consultation Conference. He also serves on several international committees, leading groups, and councils on development policy, technology, and environment. He was awarded the 1993 and 2001 Sun Yefang Prize (the highest honor for economist in China), the 1993 Policy Article Prize of Center for International Food and Agricultural Policy at University of Minnesota, the 1997 Sir John Crawford Award of the Australian Agricultural and Resource Economics Society, the 1999 Best Article Prize of the Australian Journal of Agricultural and Resource Economics, and various other prizes. A number of his working papers and journal articles may be found at the EconPapers website.

- If a firm's output is needed for national security, or if it is highly prioritized by the government, the government should support the firm.
- State-Owned Enterprises with a big domestic market should be free to attract international capital.
- State-Owned Enterprises without a big domestic market should be free to change their product to suit the market. Many such firms have excellent engineers and, if given enough leeway, should be able to produce products that will succeed in the market.
- If State-Owned Enterprises have no comparative advantage, they should be allowed to go bankrupt. In Lin's view, this would be a relatively small number of firms.

In the end, the marketing process should be upheld, especially by establishing market regulations and guaranteeing market system assumptions. Also the macro control—planning, policy, administration, and legislation—should be at the top priority with regard with to the economic performance, and good governance. Since without good governance, the central government would be ruined.

CHAPTER IV

THE ECONOMIC DEVELOPMENT IN AGRICULTURE, INDUSTRY, AND INVESTMENT

By Erlita Tantri

IV.1. Introduction

China has changed from a centrally planned (controlled by government) to a market-oriented economy (affected by supply and demand). Since 1979, China has been doing development in any sectors of economy, by modernization in agriculture and industry particularly and making transition from rural and agriculture to urban life and industrialization. Its sustainable economic development and product diversity, which spurred it to be the economy giant in term of economy in Asia, possibly in the world, make people very interested in finding out more about China.

Through a redefinition of economic development strategies by its economy policy and supported by major incentive to overall economy restructuring; China has experienced success in its economic by two decades and proved the correctness of its strategies thinking to achieve step by step modernization of its economy.

An increase in the Chinese Gross Domestic Product (GDP), national trade and foreign investment have gradually made China a leading industrialized country. China is a developing country, but its pace of development and aims make it a modern country. Economic development was stressed in the use of science and technology, besides the effect of massive, accelerating and restructuring of the Chinese economy so it is expected for China to become tough in economic globalization and in economic competition.

The development of China's economy has a long history. From the third century B.C to the 18th century, China was in the forefront of the world economy as well as, culturally, scientifically, and technologically. China's

economic reform in 1978 applied an open door policy through which many coastal cities were opened to foreign investment. Guangdong and Fujian Provinces in southeast China, relying on their proximity to Hong Kong and Macao took advantage of being the homelands of many overseas Chinese and therefore well placed to make contact with the outside world, lost no time in developing an export oriented economy. Economically, this has supported the coastal areas to become the fastest developing areas.

In the 1990s, the Chinese government decided to establish an economic development zone in Pudong, a Singapore sized piece of land wedged between Shanghai and the East China Sea. This was to speed up economic development in Shanghai and economically stimulate areas along the coast and in the Yangtze valley.³⁹

In the Swiss International Institute for Management Development, IMDs, *World Competitiveness Yearbook 2003*, both mainland China and its Zhejiang Province are placed in the first group in the global competitiveness ranking which comprises 30 countries and regional economies.⁴⁰ Mainland China is second in economic performance, stands ninth in government efficiency, and 17th in infrastructure.

IV.2. China's Economic development in General

In 1984, the economic restructuring shifted from the rural areas to the cities, and in 1992, after some 10 years of reform and opening up and with a clearer orientation towards the implementation of reforms and the establish-

³⁹ Zheng Ping, *China's Geography: Natural Conditions, Regional Economies, Cultural Features*, China Continental Press, 1998, page 35

⁴⁰ People's Republic of China Yearbook 2004, Vol. 24, page 348

ment of a socialist market economic system, the Chinese government set forth the main principles for economic structural reform as follows:⁴¹

First, the development of diversified economic elements would be encouraged while keeping the public sector of the economy in the dominant position. Second, to meet the requirements of the market economy, the operations of state owned enterprises should be changed so that they fitted in with the modern enterprise system. Third, a unified and open market system should be established in the country to link the rural and urban markets, and the domestic and international markets, and to promote the optimization of the allocation of resources. Fourth, the function of managing the economy by the government should be changed; to establish a complete macro control system mainly by indirect means. Fifth, a distribution system should be established in which distribution according to work is dominant while giving priority to efficiency with due consideration to fairness. This system would encourage some people and some places to become rich first, and then they may help other people and places to become rich, too. Sixth, a social security system, suited to China's situation, for both rural and urban residents should be worked out; to promote overall economic development and ensure social stability.

In 1987, the Chinese government set out clear and definite economic construction objectives. The first step was to double the 1980 GDP and ensure that the people have enough food and clothing. China attained this by the end of the 1980s. The second step was to quadruple the 1980 GDP by the end of the 20th century. This was achieved in 1995, ahead of time. The third step is to increase the per capita GDP to the level of the medium-developed countries by the mid 21st century. At this point, Chinese people will have achieved a high standard of living and modernization will basically be realized.

In 1997, the Chinese government stressed that the private sectors of the economy were an important part of the socialist economy of China, where

⁴¹ Economic system, China Through A Lens, China.org.cn, <http://www.china.org.cn/english/features/China2004/106995.htm>

profitability was encouraged for elements of production, such as capital and technology. By 2002, reforms in various fields were achieving remarkable results. A socialist market economic system had taken shape, and the basic role played by the market was improved in the sphere of resource allocation. At the same time, the macro control system continued to be perfected.⁴²

The increasing upward trend of China's GDP is very interesting. In 1990, China's GDP was about 1854.79 billion Yuan and in 2000 it became 8946.81 billion Yuan; it increased about 4.8 % in ten years. China tries to increase the GDP to achieve a level of prosperity and modernization. In 2003, China's GDP was 11689.84 billion Yuan and reached seventh ranking in the world.

Table 4.1
GDP and Per capita Average from 1978 to 2003

Year	GDP (billion Yuan)	GDP Per Capita (Yuan/person)
1978	362.41	379
1985	896.44	853
1990	1854.79	1634
1995	5847.81	4854
1997	7446.26	6054
1998	7834.52	6308
2000	8946.81	7086
2003	11689.84	9073

Source: China's Economy, 2004⁴³ and People's Republic of China Yearbook 2004, Vol. 24

⁴² Ibid

⁴³ Wang Mengkui and Others, *China's Economy*. China Basic Series, 2004. China Intercontinental Press, 2004, page 6

Increase of income per capita and the GDP can be ascribed to the increase of industry and agriculture in China. For two decades, from 1978 to 2000, China's GDP increased on an average of 9.3 % each year. China's GDP per capita in 2000 (7,086 Yuan per person) was almost ten times that in 1985.

When the economic crisis hit Asian countries, China was enjoying a high rate of economic growth. The Asian countries tried to recover their economies even though the growth was slow and did not improve on what had existed before. Nevertheless, China could cope, even if its economy was growing slowly as well. Furthermore, China was able to reach its original official target of production for a harvest of 500 million tons of cereal in 2000, in 1998, two years earlier.

The development of the economy has changed the people's prosperity for the better. China is trying to install a social security program, a national education, medical care system etc, step by step all in accordance with the pace of its economic growth. China with a population of more than 1.4 billion people tries to build up an all round society of initial prosperity and industrialization by the year 2020 and achieve virtual modernization with a population of 1.5 billion by mid 21st century.⁴⁴

Modern China tries to develop an open economy by joining in international economy cooperation and competition. The country tries to boost multilateral and bilateral economy cooperation with other countries and regions. China is experiencing fast growth both in exports and imports and its exports are significant in relation to the country's total demand. To boost export activity, China has been trying to maintain a low tariff wall and lift non-tariff barriers and formulate and institute systems and policies to encourage exports.

Since its open door policy, China has been increasing exports. Now, it is popular as a big exporter in Asia. The value of exports is increasing faster than the value of imports; indicating that China has improved in economic

⁴⁴ Ibid, page 21

development and export growth is important as a generator of industrial growth. Between 1980 and 2001, China's processed trade exports rose at an annual rate of 29.4% or 19.8% and 13.8% points higher than other exports and imports in the same period. The contribution of the processed trade in exports and imports in those years accounted for 59.2% and 41.5% of the national total.⁴⁵

Table 4.2
Total Value of Imports and Exports

Year	Unit: US \$100,000,000		
	Total Exports	Total Imports	Total Exports & Imports
1978	97.5	108.9	206.4
1979	136.6	156.7	293.3
1980	181.2	200.2	381.4
1981	220.1	220.2	440.3
1982	223.2	192.9	416.1
1985	273.5	533.5	696.0
1990	620.9	533.5	1154.4
1995	1487.8	1320.8	2808.6
1998	1837.1	1402.4	3239.5
1999	1949.3	1657.0	3606.3
2000	2492.0	2250.9	4742.9
2001	2661.0	2435.5	5096.5
2002	3256.0	2951.7	6207.7
2003	4382.3	4127.6	8509.9

Source: People's Republic of China Yearbook 2004

⁴⁵ Ibid, page 76

China's exports and imports were of both primary and manufactured goods. Most of China's exports in primary goods come from food and live animals used for food, beverages and tobacco. Its exported manufactured goods come from light and textile industrial products, rubber products, minerals, and metallurgical products. China's products are popular in developing countries. Some Chinese commodities in 2003 had enormous volume and value, such as cereals and flour, raw and manufactured cotton, medicine and electronics. Table 4.3 below shows the value and volume of China's export commodities in 2003.

Table 4.3

Major export Commodities in Value and Volume in 2003

Item	Volume	Value (1000 Yuan)
Cereal and flour (10000 tons)	2,194	265,708
Raw cotton (ton)	112,020	13,257
Crude oil (10000 tons)	813	166,122
Medicine (ton)	303,576	285,812
TV sets (10000 sets)	4,765	347,159
Diode and semiconductor device (1000)	10,641,127	173,320
Textile yarn, fabrics	-	2,692,824
Automatic data-processing equipment, components (10000)	93,542	4,111,195
Spare part of automatic data-processing equipment (ton)	1,142,781	1,822,649
Garment and accessories	-	5,191,638
Footwear	-	1,295,501
Plastic articles (ton)	5,482,683	731,766
Toys	-	597,930

Source: People's Republic of China Yearbook 2004, Vol. 24

Chinese products flood Asian and many European countries. China's foreign trade has exceeded the average GNP rate and gone above the average of international foreign trade levels. However, China still depends on imports as an indicator of the economy's degree of openness.

Since 1985 China has effectively realized the transition from a primary goods based export structure to a manufactured goods based export structure. Most manufactured goods exported are textiles, medium and low grade machinery and electrical appliances. Furthermore, China tries to apply an intensive model, the success of which comes through quantity and technology rather than good quality of low quantity and cheaply priced goods. About two hundred and seventy five billion dollars and over half of all the exports of China were sold on international markets and were produced by firms using foreign investment, either in joint venture or wholly foreign owned companies.

In the period 1977-2001 China's trade grew from about fifteen billion dollars to five hundred and ten billion dollars. It now ranks as the seventh largest trading country in the world. No country has increased its role in the international trading system as fast as China in the last twenty five years. This was even more rapid than the growth of Japan as a trading country. Thus, China's domestic economic growth has been very fast as has its expansion into international markets.⁴⁶

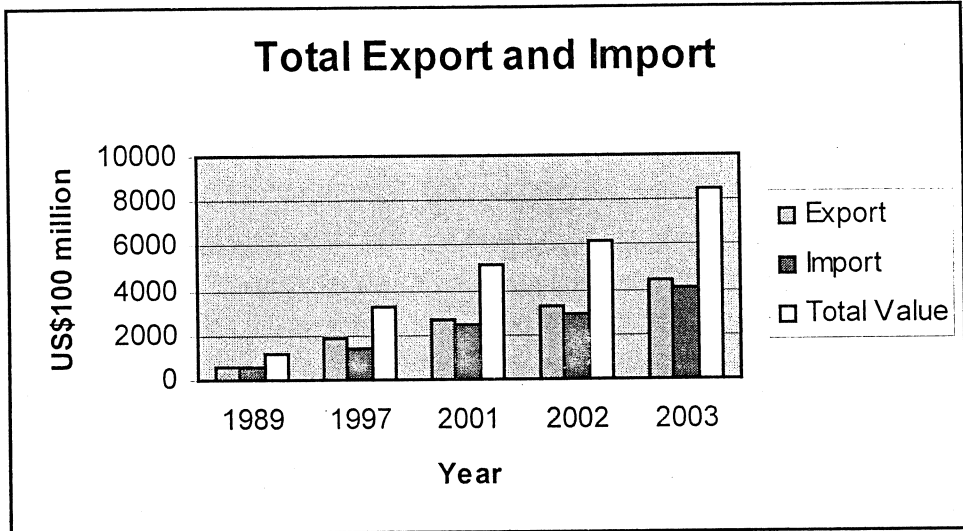
According to a research report of the Asian Development Bank, China may become a leading exporter in Asia by 2010 and a leading Asian importer in 2005. A further involvement in the world economy trade system by China is needed in the global economy. Besides, as a developing country China is experienced in handling the pressures of advantages from developed nations

⁴⁶ Nicholas R. Lardy, *The Economy Future of China*, Speeches in Asia Society, April 29, 2002

in economic strength and science and technology in the field of economic globalization and the global economic competition.⁴⁷

Graph 4.1

Total Exports and Import from 1989 to 2003



Source: *People's Republic of China Yearbook 2004, Vol. 24*

China's dependence on trade has been on the rise along with the growth of the volume of its foreign trade and its dependence as a whole that reached 60.4% and on export reached 31.1% in 2003.⁴⁸ The Open policy has made China active in international trade market in exports and imports, especially after China became a member of world trade organization (WTO) in 2001.

Nevertheless, China has problems in the economic and social development including: slow growth of farmers' income; heavy pressure on employ-

⁴⁷ Op. cit Wang Mengkui and others, page 16

⁴⁸ Ibid, 76

ment and social security; high demand of energy for transportation; large size of investment in fixed assets; blind investment and repeated low-quality expansion in some industries; big gaps in the income between selected groups of population; relatively difficult life of low income earners; increasing pressure on resources and the environment; etc.⁴⁹

IV.3. China's Agriculture

Agriculture is the foundation of China's economy despite its huge population but limited arable land for farming. Since the establishment of the People's Republic of China; the development of agriculture and the rural economy has been buffeted by three problems: First, lack of supply of agricultural products because of limited land but a huge population. Second, farmers' low incomes resulting in chronic poverty and fewer job opportunities; and Third, insufficient sustainability in agricultural development because of a weak basis and scarce investment. After the adoption of reforms and the open door policy, the three problems have been significantly reduced through the reform of production relations in rural areas, especially reform of the rural land system. Besides, this reform has had a profound impact too on the economy and social transition of China.⁵⁰

Chinese reformers tried to regulate and control the market and guide enterprises through the market, abolish the unified and fixed state purchase and sale and the monopolized purchase and sale of agricultural products, which were the most difficult to reform. Nevertheless, except for products, which required a good management system and should be carried out with regard to the protection of the ecology and resources, China has been well able to raise 80% of its agricultural products.

⁴⁹ People's Republic of China Yearbook 2004, Vol. 24, page 315

⁵⁰ Chi Fulin, China's Economic reform at the Turn of the Century. China Institute for Reform and Development, Foreign Language Press Beijing, 2000, page 280

The change of policy from the people's communes that Mao established into a system of family based farming encouraged the farmers to greater enthusiasm and eventually made China's rural areas increase their productivity, productive land, and peasant per capita income. The first batch of economic reform (1979 - 1984) refocused on the agricultural sector. In 1981, one of Zhao's ministers said in the Government's Plan of Work for Economic Development that the Chinese government wanted to accelerate agricultural development with appropriate policies and scientific thinking.⁵¹

Significantly, China set up economic structural reform by encouraging people to develop economic activities, they were allowed to get rich first through honest labour and legal operations aimed at prosperity. Science, technology and education were regarded as the pillars of agricultural advance and scientific and technical personnel were encouraged to go to the countryside to assist the progress of agriculture.⁵² The bulk of China's population is located in the countryside. Without stable rural areas there will be no stability in the country, and the key to a stable and prosperous countryside is in increasing the farmers' enthusiasm to work in their own interests.⁵³

China has farmland of about 1.431 billion *mu* (15 *mu*=1 hectare). This makes about 1.22 *mu* per capita and about 200 *mu* of farmland is in reserve. There is possibility that per capita cultivated land will drop to 1.11 *mu* by 2000 and 1.02 by 2010 as a result of the pressure of population growth.

Actually, China has 128.68 hectares of forest covering 13.4% of its land.⁵⁴ The land use rights, stable land tenure, and readjustment of land have supported China's agriculture and the rural economy that at the end might

⁵¹ Poltak Partogi Nanggolan, Reformasi Ekonomi RRC Era Deng Xiaoping: Pasar Bebas dan Kapitalisme Dihidupkan Kembali, Pustaka Sinar Harapan, 1995, page 147.

⁵² Gao Shangquan and Chi Fulin, The Reform and Development of China's Rural Economy Foreign Language Press, Beijing, 1997, page 25

⁵³ Ibid., page 27

⁵⁴ Li Jingwen, the Chinese Economy into the 21st Century, Foreign Language Press Beijing 2000, page 8.

increase the growth of rural investment. Thus, it will bring higher land productivity, a steady supply of agricultural products, and continuous increase in farmers' incomes.⁵⁵

Technically, China has succeeded in increasing its production of agriculture because of the extensive use of irrigation, chemical fertilizer and pesticide and updating of seed. Since the reform policy and the opening up, China has greatly increased its food products and most other farm products. China has taken a lead in quite a number of major farm products in the world, catching up to the average world level in per capita output. Adequate supply in the domestic market and stability in supply and demand in normal farming years and surplus in years of good harvest are very satisfactory.

Economic development, including increasing productivity and modification of agricultural structure, and agricultural productions, has been progressing rapidly for 26 years. In 2002, China had about 130,040,000 hectares or about 13.54% of its total area of land for farming. The majority of the farm products come from grain, cotton, oil-bearing crops, and meat.

Table 4.4
Major Farm Products

Year Products (10000 tons)	1989	1997	2001	2002	2003
Grain	40755	49417	45264	45706	43070
Cotton	379	460	532	492	486
Oil-Bearing Crops	1295	2157	2865	2897	2811
Meat	-	5269	6334	6587	6933

Source: People's Republic of China Yearbook 2004, Vol. 2

⁵⁵ Op. cit Chi Fulin, page 281

For five years, 1996-2000, the total agriculture in the GDP came to 7,129.18 billion Yuan. The annual average growth rate stood at 3.5%, calculated according to constant prices and showing a tendency towards stable growth. Grain and other major agricultural products had bumper harvests for many years. In 2003, China's grain output was 430.70 million tons, less than the previous year because of a decrease in planted areas and serious natural disasters. The amount of grain per capita was 334 kg; and the amount of meat (pork, beef, and mutton), milk, and aquatic products per capita reached 42.7 kg, 13.6 kg, and 36.5 kg, respectively, exceeding the world's average levels. Today China leads the world in production of grain, cotton, rapeseed, peanuts, meat and fruit.

Total farming has been increasing, although, after 1997, the grain production declined because of the decline of demand and the economic crisis that hit Asian countries. The progress of agricultural production occurred since the establishment of the People's Republic of China in 1949. Grain output has risen from 113, 180,000 tons to 430,500,000 tons in 1949 and in the record year 2003 it was 512,300,000 tons. Between 1979 and 2002, China's GDP from agricultural production registered an average annual increase of 4.6%, which is markedly faster than the world average.⁵⁶ Furthermore, fluctuation of grain prices has become an indicator of imminent crisis.

⁵⁶ *op. cit.*, Wang Mengkui and others, page 88

Table 4.5
Structure of Gross Output Value of Agriculture (in percentages)

Item	1989	1997	2001	2002	2003
Farming	62.7	58.2	55.2	54.5	50.1
Forestry	4.4	3.5	3.6	3.8	4.2
Animal Husbandry	27.6	28.7	30.4	30.9	32.1
Fishery	5.3	9.6	10.8	10.8	10.6
Service to Agriculture Industry	-	-	-	-	3.0

Source: People's Republic of China Yearbook 2004

Farming, especially of grain, has great value. China reaped bumper crops of food grain in 1998, with the peak of 500 million tons. Furthermore, China was capable of feeding its population with food grain and other farm products from its relatively insufficient farmland because of the application of agricultural science. Besides, the sale of a variety products is supported by integrating trade, industry, and agriculture into one combined production, also supported by processing in product marketing, the products traded are chickens, ducks, beef, milk, pigs, rabbits, aquatic products, fruit, tea, and silk worm cocoons.

In 1994 the vegetable growing areas in China totaled 126 million *mu*, equivalent to the total cultivated land of Guangdong, Guangxi, and Fuzian. In 1993 the total output of vegetables reached 210.6 billion kg. Now, the per capita consumption in cities is more than 150 kg annually. Of the expenditure per capita in cities, 50% goes on basic foodstuffs, 35% goes on non staple foodstuffs, and 5% on vegetables.⁵⁷

⁵⁷ Op. cit Gao Shangquan and Chi Fulin, page 142

The productivity of agriculture has been increasing and growing as rapidly as the modern sector. It is because agricultural technology has been highly effective in generating high volume and value of the output. Besides, the declining cost and price of technology have improved productivity and products.

China's agricultural reform came through three major stages; with the First from 1978 to 1984, when China gradually set up and implemented the contract responsibility system based on the household and with remuneration linked to output in the rural areas. The Second stage was from 1985 to 1991, when China reformed the system of state monopoly purchase and quotas, and gradually lifted controls over markets and prices of agricultural products. The Third stage was from 1992 to 1994, when the country started the transition to the rural market economy in a comprehensive way.⁵⁸

First stage is called breakthrough stage (1978 to 1984). This stage emphasized on the development of agriculture. The Third Plenary Session of CPC's 11th National Congress in December 1978 paid great attention to agricultural problems because agriculture was the foundation of national economy that had suffered from serious damage. Based on this situation the plenary session put forward a series of political and economy measures for developing agricultural production by lightening the burden of peasants, mobilizing their initiative and freeing them from anxiety.⁵⁹ In 1980, CPC's Central Committee held a symposium to discuss how to perfect the agricultural production by responsibility system.

The contract responsibility system based on household and remuneration linked to output in China's rural areas emancipated peasants from land property and status and gave the impetus to produce high economic agricultural commodities. The freedom and property rights of peasants in economic activities developed diversification of economic products. The household con-

⁵⁸ Ibid, page 1

⁵⁹ Ibid, page 2

tract system was the micro economic system's foundation for the growth of the market system.

This system fired farmers with a great enthusiasm for work and brought about encouraging changes to rural China. The family based farming system not only promoted an overall development of crop cultivation but also boosted the development of family based animal husbandry and aquaculture; and led to the emergence and development of township industries.⁶⁰ Through this effort, China's people (22 % of the world population) could feed themselves, even though they only have 7% of the world's total farmland.

At the First Stage, China's government tried to concentrate on improving the agricultural policy to have a good foundation for the first step of China's economy. In 1984, the State Commission for Restructuring the Economy, the Ministry of Commerce and the Ministry of Agriculture, Animal Husbandry and Fisheries adopted the following reform measures in the circulation of agricultural products:

First, China should develop a diversified economy, including state-owned, collectively-owned and individual-owned economies, adopt various economy forms and implement multi channel circulation. Farmers should be encouraged to enter the circulation field, and should be allowed to engage in the exchange of commodities.

Second, go on reducing purchase by government quotas. Third, to improve the methods of managing prices, it was specified that all agricultural and sideline products be purchased according to the state plan and quotas included in the plan and purchased at the planned purchase price.

Fourth, in the reform of the wholesale system of agricultural and sideline products, it was required to change the wholesale system by unified purchase and supply according to administrative division and levels, and abolish

⁶⁰ Zheng Ping, *China's Geography: Natural Conditions, Regional Economies, Cultural Features*, China Continental Press, 1998, page 37

unreasonable operational links. The basic operational link of agricultural and sideline products were in the countryside, where special wholesale companies could be set up.

Fifth, to hasten the reform of supply and marketing cooperative systems, it was required that the supply and marketing cooperatives make a breakthrough in helping farmers to become shareholders, expand the scope of operations and services, and manage distribution according to work, prices etc., on the principle of changing “the government run” into the “non government run.”

Sixth, to actively develop the processing industry of agricultural and sideline products, to help satisfy the need to improve the people’s livelihood, perfect China’s food structure, make agricultural and sideline products more useful and help solve peasants’ difficulties in purchasing and selling products.

Seventh, to greatly develop communication and transportation and facilities for commodity operations, it was stressed that due to constant development of production and circulation of rural commodities, and the steady expansion of horizontal economic connections, the stumbling blocks of inadequate communication, transportation and commercial facilities became more prominent.

Within 26 years, from 1952 to 1978, agriculture provided 800 billion Yuan as an investment fund for rural industrialization. Agriculture developed rapidly because of the construction of farmland, irrigation facilities, and farm mechanization.

In 1984, China recorded a grain output increase of 500 million tons. It turned China from the world’s largest importer of food grain into a net exporter of food grain.⁶¹ The institutional reform of agriculture has also led to a great expansion of the rural industry. The increase of peasant income also spurred the development of the non agricultural sector in rural China and gave

⁶¹ Op. cit, Wang Mengkui and others, page 31

rise to a large scale movement of workers from agricultural to industrial development, thus bringing forward the country's industrialization drive as a whole.⁶²

Since the initiation of the reform and open door policies, China has used a variety of methods to raise rural incomes, allowing contracting of farmland, establishing rural enterprises and raising the purchase prices for agricultural and related products. During the Sixth Five Year Plan period, increased agricultural production contributed 41.03% of the newly created rural income, non-agricultural production 37.83 % and sideline products 21.14%.⁶³

At the Second Stage (1985 to 1991), China wanted to make further reforms in unification and fixed state purchase of agricultural products and change the rural production structure. During the Seventh Five Year Plan (1986 to 1990), agricultural production supplied 26.79% to rural income. However, to raise peasant income, it was necessary to raise the productivity of agriculture and make more intensive use of the land.

The Chinese government began to build a special food grain storage system in 1990 and the storage capacity has grown to 40 million tons. This does not include the 10 million tons of storage capacity of local government facilities. Chinese farmers themselves store their own surplus grain at home, which is estimated to reach 150 kg per household on average; totaling 120 million tons. All this and the national grain reserve for Defence and the commercial grain inventory for circulation may add up to the grand total of more than 200 million tons.⁶⁴

In 1992, at the Third Stage, the output of grain and other agricultural products increased by a large number and there was development of small towns in rural areas together with rural industrialization. In 1997, China suc-

⁶² Ibid, page 32

⁶³ Op. cit, Li Jingwen, page 46

⁶⁴ Op. cit, Wang Mengkui and others, page 91

ceeded in producing 492 million tons of grain, 4.3 million tons of cotton, 21.5 million tons of oil bearing seeds, 53.54 tons of meat and 35.61 million tons of aquatic products. These are among the world's biggest national outputs. Within the agricultural sector, grain production has increased steadily, cash crops have developed at a rapid pace, and forestry, animal husbandry and fisheries have grown even more rapidly, a condition creating a better national economy.⁶⁵

The Gross Domestic Product (GDP) in 1997 amounted to 7.44772 trillion Yuan (US\$903 billion), putting China among the top ten countries in the world in economic strength.⁶⁶ According to Morgan Stanley, the total productivity factor of the agricultural sector in China has been growing at about 4 % per annum, about the same as that of the non-rural sector, which indicates a new surge in rural development and investment in the coming years.⁶⁷ It is because agricultural technology has been highly effective in generating high value added output. Furthermore, greenhouse technology and new seeds have been instrumental in the improvement in agricultural productivity. The declining cost of technology may have contributed to the high total productivity rate factor.⁶⁸

In 2003 China's exports and imports of agriculture products amounted to 40.4 billion US dollars in value, accounting for 4.2% of the country's total exports and imports. The Chinese government is trying to boost its export of farm products, especially the export of animal products.

The Chinese government tried to play an indirect role in market agricultural development by implementing some actions: First, take financial mea-

⁶⁵ Op. cit, Zheng Ping., page 38

⁶⁶ Ibid., page 39

⁶⁷ China's Agriculture More Profitable Than Modern Sectors in Coming Years: Morgan Stanley, Beijing Time, February 23, 2002

⁶⁸ According to Andy Xie, chief economist for Morgan Stanley's Asia Pacific, China's Agriculture More Profitable Than Modern Sectors in Coming Years: Morgan Stanley, Beijing Time, February 23, 2002

asures to guarantee the average profits of agricultural production by trying to balance industrial and agricultural development through regulating industrial and agricultural taxes; Second, in financial policy, provide special loans and support credit from agricultural banks as support of investment in agriculture; Third, in the welfare policy, erect agricultural insurance bodies and rural medical insurance; Fourth, in administrative legislation, protect resources and support the price and investment in science and technology; and Fifth, protect agricultural resources such as arable land in order to guarantee long term stable growth of the national economy.⁶⁹

Agricultural growth is also affected by other environmental factors, such as agricultural trade conditions, non agricultural sector growth, employment opportunities, population increase, manpower and capital input, and the environmentally influential agricultural technologies.

IV.4. China's Industry

China experienced a growth in industry from 1978 to 2003, which supported the increase of China's GDP 32 times, at an average annual rate of 15%. China has reached the status of being an industrial country, which has had a complete industrial system at a fairly high level of technology.⁷⁰ By industrial acceleration, China's industrial structure has improved from a lower to a higher level.

Chinese industry grew twice as fast as the GDP. The ratio of industry to the national economy kept growing from 37% in 1990 to 45.3% in 2003. The country's 2003 total gross industrial output (output value) reached 14,148.12 billion Yuan, up 27.2% over that of the previous year.⁷¹ All this shows the industrialization process in China is gathering speed.

⁶⁹ Op. cit Gao Shangquan and Chi Fulin, page 46

⁷⁰ Zheng Ping, *China's Geography: Natural conditions, Regional Economies, and Cultural Feature*. China Intercontinental Press, 1998, page 36

⁷¹ Op. cit, Wang Mengkui, page 131

The changing industrial structure of China mainly comes through the evolution of two factors: per-capita income levels and the supply of the key elements (capital, machine, labor, and natural resources). Increased income leads to change the demand structure while changes in the supply of key elements lead to change in trade and corresponding technologies.⁷²

China is trying to pursue a new type of industrialization that is not only the development of industry itself and the rise of the technical level but also the fundamental technical transformation of agriculture and the resultant major readjustment of the industrial and employment structures by technical progress and the growth of the tertiary industry.⁷³

Industry in the last two decades was of the ratio of added value of primary industry to the GDP going down from 15.9% to below 10%, secondary industry down from 50.9% to 30-40% and tertiary industry up from 33.2% to 50-60%. This condition was achieved in the 1980-2000 period.⁷⁴ China expects that by the year 2020, the development of industry will have brought its population into prosperous living condition.

Since the start of the reform and open door policies, China's economy has entered a stage of comprehensive industrialization and significant change that have taken place in the industrial structure. From 1978 to 1992, secondary industry, especially manufacturing industry, maintained an average annual growth rate of 10.7%.

In manufacturing, the market based incentive system was first introduced in small factories controlled by townships and villages. Then, between the 1980s and the early 1990s the government gradually expanded its incentive based policies to some larger enterprises. Special export focused industrial zones, which made extensive use of foreign capital and private ownership

⁷² Op. cit, Li Jingwen, page 41

⁷³ Op. cit, Wang Mengkui and others, page 12

⁷⁴ Ibid, page 13

structures, were also established to support export markets. These reforms were very successful and produced rapid economic growth; about 7.8% annual averages between 1990 and 2002.⁷⁵

Table 4.6
Industrial Categories

Large Groups	Medium Groups	Small Groups	30 Industries
Primary Industry			Agriculture
Secondary Industry	Mining		Coal Mining Crude oil and natural gas Metal ore mining Non-metal ore mining
		Industry	Light Industry
	Materials, Energy		Paper and products Electricity and hot water Petroleum processing Coal processing and products Chemicals Non-metal mineral products Metals smelting and products Metal products
	Processing Industry		Machinery and equipments Transport equipment Electric equipment Electronic equipment Instruments and meters Maintenance and repair Other manufacturing products
	Construction		Construction
Tertiary Industry			Transport and communication Commerce and restaurants Social services Finance and insurances Public administration

Source: The 30 categories shown above are taken from "Sector Analysis of Chinese

⁷⁵ The Conference Board/Groningen Growth and Development Centre Total Economy Data Base, in H McGuckin and Matthew Spiegelman, Restructuring China's Industrial Sector: Productivity and Jobs in China, East Asian Economy Perspective, Vol.15, No.2, August 2004, page 60

Economic development, & New Input-Output Rankings Using Comparable Prices.”⁷⁶

GDP can come from the industrial structure consisting of primary industry, secondary industry, and tertiary industry.

Table 4.7
Total Value of Industry (in 100 million Yuan)

Item	1978	1989	1997	2002	2003
Gross Domestic Product	3624	16909	74463	105172	116898
Primary Industry	1918	4228	14211	16117	17092
Secondary Industry	1745	7278	37223	52980	61131
Industry	1607	6484	32412	45975	52963
Construction	138	794	4811	7005	8168
Tertiary Industry	861	5403	23029	36075	38675

Source: *People's Republic of China Yearbook 2004, Vol. 2*

Table 4.7 shows that most of the value of the GDP was contributed by secondary industry. In the first reform, primary industry made the highest contribution to the GDP, because the focus of reform was on the agricultural sector. Since the 1980s, secondary industry has made the highest contribution after an increase of investment and technology. Secondary industry contributed to the growth of the GDP from 48.6% in 1978 to 59.2% in 1992, with industrial manufacturing rising from 44.8% to 55.4% over the same period.⁷⁷ With the development of industry, a larger portion of the national income will be transferred to the countryside through price levels and rural incomes raised. It is also important for pre conditions of the development of agriculture in the future.

⁷⁶ China's Economy Development and the Role of Foreign-Funded Enterprises, Economy and Industrial Research Department Development Bank of Japan, May 2003

⁷⁷ Op. cit, Li Jingwen, page 42

Between 1978 and 2002 agriculture based primary industry increased by 200%, when manufacturing based secondary industry increased by 420% and tertiary industry by 370%. Primary industry as a portion of the GDP fell from 28.4% in 1978 to 17.3% in 1992, decreasing by 11.1% while secondary industry increased from 48.6% to 60.8%, with manufacturing similarly rising from 44.8% to 56.2%. For tertiary industry, it came more slowly, rising from 23% to 25.7%. It is clear that the most rapid increase was found in manufactured added value: 11.4%.⁷⁸

The development of industry supported by the incentive mechanism improved. To further improve the incentive mechanism of the state owned enterprises, the Chinese government allowed the state owned enterprises to share the profits of the state, in the mid 1980s. This meant, the state owned enterprises were allowed to retain greater profits for their own use.

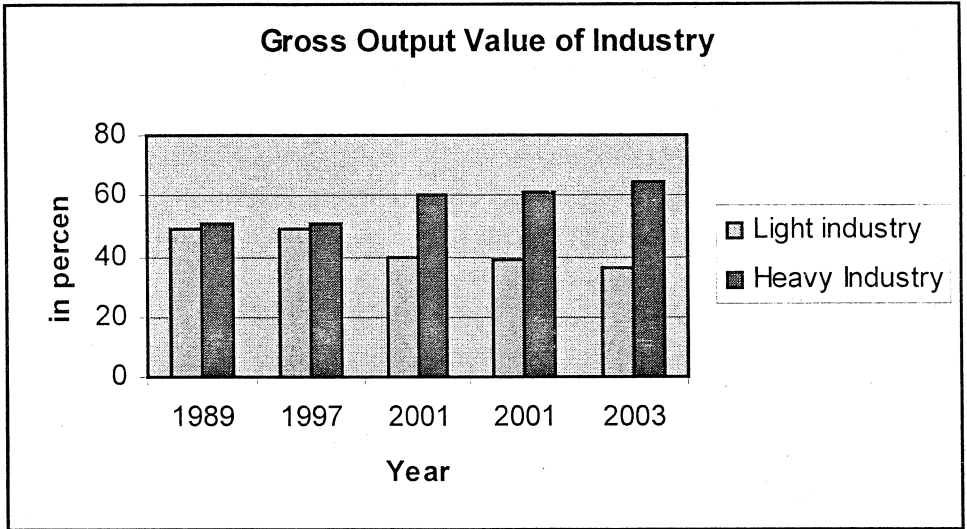
Light industry developed more quickly than heavy industry in the 1980s. Light industry expanded by 790% between 1978 and 1992 whilst heavy industry 530%. The average annual growth rate of light industry was 14% and that of heavy industry was 10.6%.⁷⁹ China was restructuring its heavy industries between 1995 and 2002. Approximately 51,000 of China's largest industrial enterprises cover the mining, the manufacturing and the utility sectors⁸⁰

⁷⁸ Ibid, page 34

⁷⁹ Ibid., page 57

⁸⁰ Robert H McGuckin and Matthew Spiegelman, *Restructuring China's Industrial Sector: Productivity and Jobs in China, East Asian Economy Perspective*, VOL.15, No.2, August 2004, page 59

Graph 4.2
Gross Output Value of Industry (in percentages)



Source: *People's Republic of China Yearbook 2004, Vol. 2*

Chinese economic growth was also contributed to by the surge in industrial output that turned out to be the major driving force behind the rapid economic growth. NBS (Chinese National Bureau of Statistic) figures show the value turned out by the industrial sector accounted for 71.6% of the Gross Domestic Product (GDP) in 2003; contributing 6.5% to the 9.1% overall economic growth. NBS spokesman Yao Jingyuan acknowledged that heavy industry had taken the lead in industrial growth, signifying the start of a comprehensive upgrading of the economy. This meant the Chinese economy was at a new stage of development.⁸¹

⁸¹ 9.1% Surge Epitomizes Sound Growth of Chinese Economy, January 21, 2004, www.china-un.ch/eng/ljzg/shjjtj/t85858.htm

Since the 1950s, the trend away from the agricultural sector toward industrialization has been dramatic, and is a result of both policy changes and free market mechanisms. During the 1950s and 1960s, heavy industry received most attention and consequently grew twice as rapidly as agriculture. After the reforms of 1978, more attention to the agricultural sector as well as a move away from heavy industry towards light industry resulted in agricultural output almost doubling with only marginal increases for industry.⁸²

China is at the first rank in the world for the production of raw coal and cement, in the production of consumer electronics and home appliances, such as television sets and refrigerators. Since 1996, China has been in the lead in the production of steel, coal, cement, farm use chemical fertilizer and television sets.⁸³ For many years China has also been leading the world in many other industrial products and has been one of the forerunners in the output of crude oil, electricity, chemical fibre, cotton cloth, and sugar. In 2003, China was in the first rank in the output of more than 100 industrial products in the world.⁸⁴

Actually, large scale reform of China's industries began in 1984. Since then, the Chinese government has made a series of reform policies in the hope of bolstering the production of state owned industries and boosting their productivity through gradual marketing and institutional changes.⁸⁵

The increase of township enterprises also made a big contribution to industrial growth. The number of township enterprises increased to the annual average of more than 26.6% in 1979-1992 and contributed 10% in 1980 and 42% in 1994 to industrial growth. Furthermore, the enterprises with foreign

⁸² Andrew Papadimos, The PRC's Industry Structure, articles is from Chinese Business Center, <http://www.china-biz.org>

⁸³ Industry, China Through a Lens, China.org.cn, <http://www.china.org.cn/english/features/China2004/106984.htm>

⁸⁴ Op cit Wang Mengkui and Others, page 134

⁸⁵ Ibid, page 32

investment have given important motivation to the development of China's manufacturing industry. In 2002, the foreign funded enterprises in China accounted for 25.7 % of the added industrial value, 21% of the taxes, 31% of the profit, 52% of the exports, and 54% of the imports of the manufacturing industry in China.⁸⁶

Many multi national corporations have moved their manufacturing centres to China because they can better use the cheap and efficient Chinese workers and the tremendous processing capacity in China to carry out production for the world market. In addition, while China's huge population is indeed a heavy burden it also has the advantage of being a potential domestic market, which is larger than that of any other country.

As a populous country with experience in employment problems, China has an advantage in the abundance of human resources. China through its national education program is trying to rapidly improve a large number of scientific, technical and managerial personnel at various levels who are expected to play a positive role in different fields, such as research and the application of technology in industry and agriculture, and as a think tank on modernization.

IV.5. Development of Investment

China tried to revise its economic relations with foreign countries and tried to obtain equipment and technology during its first stage of reform. To attract foreign investment, China tried to make the best use of its favourable geography, a comfortable investment environment, good infrastructure, preferential treatment in taxation, the supply of parts and accessories, good service systems, quality personnel, scientific and technological levels and administrative efficiency to attract investment from those world outstanding multi na-

⁸⁶ Ibid, page 134

tional corporations and enterprise groups at large scale and high technology levels. Furthermore, inland provinces and cities tried to attract small and medium sized investment by their advantage in low land use fees and cheap labour.

From the late 1970s, along with the implementation of economic reform and open door policies, many coastal areas have been opened up to accept foreign investment. For example, Guangdong and Fujian Provinces in southeast China, were poised to take investment from Hong Kong Macao and Taiwan, where many overseas Chinese were interested in taking up any advantage in China.

Being a big country and having practiced a planned economy for a long time, China could not create a domestic market and open up entirely to the outside world in a short time. Thus, China has set up special zones that started with Shenzhen and some other coastal cities in order to energetically develop export oriented industries. The other reason why the Chinese government opened coastal areas to the outside world was that most coastal areas had better industrial bases and were more economically developed; moreover they had better investment environments, good infrastructure, people's understanding and local capacity in making accessories and parts.

Table 4.8
Total Investments in Fixed Assets

Year	State-Owned and Others Types of Ownership	Collective-Owned Units	Private Economy	Total 100 million Yuan
1982	845.3	174.3	210.8	1230.4
1983	952.0	156.3	321.8	1430.1
1984	1185.2	238.7	409.0	1832.9
1985	1680.5	327.5	535.2	2543.2
1990	2986.3	529.5	1001.2	4517.0
1995	14169.7	3289.4	2560.2	20019.3
1998	20469.6	4192.2	3744.4	28406.2
1999	21230.4	4338.6	4195.7	29854.7
2000	23406.9	4801.5	4709.4	32917.7
2001	26505.3	5278.6	5429.6	37213.5
2002	30993.3	5987.4	6519.2	43499.9
2003	39748.0	7806.9	7563.0	55117.9

Source: People's Republic of China Yearbook 2004, Vol. 2

Most of the total investments came to state owned enterprises. State Owned Enterprises (SOEs) have long been known as the main providers of goods and services in China, under the direct control of the government. SOEs are enterprises the assets of which are owned by the state; collectively owned enterprises are enterprises the assets of which belong to state collectives, including villages, enterprises; and the private economy is enterprises that belong to individuals. Besides, there are Foreign Funded Enterprises (FfEs) defined as enterprises with registered foreign ownership, including joint ventures, collaborations, and 100% foreign owned enterprises. In the Ninth Five Year Plan (1996-2000), SOEs were reformed with the focus on supporting large SOEs, while small SOEs were sold or merged. China also introduced modern corporation forms such as changes in joint stock companies and establishment of holding companies.

In the mid 1990s apparently there was a new trend in the use of Foreign Direct Investment (FDI) in China, for example, investment in China by international consortiums and multi national companies began to grow fast in both their volume and ratio to the total foreign investment in this country. Statistics show that more than 400 to 500 of the largest non-banking corporations in the world already have investment projects in China. And about 400 multi national corporations have set up their research centres in China.⁸⁷

FDI is an attractor that has been an important component of China's open door policy. It is important to access valuable capital and even more important to bring in an advanced technology. Experienced foreign managers will also direct the country to the overseas market and competition.

China's government has taken a series of measures to attract foreign capital and increase the foreign direct investment. By the end of 2003, China approved 465,277 foreign funded enterprises with combined foreign investment on contract of 943.13 billion US dollars and actual foreign investment of 501.471 billion US dollars. Since 1993, China has been one of the leaders in the world in absorbing foreign direct investment for ten consecutive years.⁸⁸

An enormous population has an advantage because it provides abundant and cheap labour power and forms a large domestic market. The huge Chinese domestic market facilitates Chinese enterprises to push a division of labour in the domestic market to form economic scale and increase overall competition and it is attractive to foreign investment and the introduction of overseas resources, capital, technology, experienced management. To attract more foreign investors, the Chinese government has become more open to the outside world, increased the transparency of its policies, strengthened the protection of the intellectual property rights and stepped up the development to help make overseas investors more confident to invest in China.⁸⁹

⁸⁷ Ibid, page 62

⁸⁸ Ibid.

⁸⁹ Ibid, page 146

At the first stage of reform to open up China, the investment mainly took the form of joint ventures and cooperative ventures between Chinese and foreign capital. Later, foreign investment was set up as foreign owned enterprises. In 2002, the solely foreign funded enterprises already accounted for 65 % of the total FDI projects, 69 % of the investment contracts and 60 % of the annual investment capital.

Table 4.9

Volume of FDI in China and its ratio to world total in different years

Year	Direct Foreign Investment (billion US\$)	Percentage of World Total (%)	Ranking
1990	34.9	1.80	13
1991	43.7	2.97	12
1992	110.1	6.92	5
1993	275.2	13.30	2
1994	337.7	14.54	2
1995	375.2	12.11	2
1996	417.3	11.95	2
1997	452.6	10.24	2
1998	454.6	7.34	3
1999	403.2	4.66	3
2000	407.7	4.10	6
2001	468.8	6.38	6
2002	527.1	8.10	1
2003	535.1	8.19	1

Source: *China's Economy*⁹⁰

⁹⁰ Ibid, page 64

The FDI in China focused on the manufacturing industry. By the end of 2002, the manufacturing industry in China had reported 70% of the number of enterprises with FDI, from 58% of the total FDI and 62% of their registered capital. In the service trades, FDI concentrated on the real estate industry. In geographical distribution, FDI mainly concentrated on the Chinese coast as a better environment and the basis from which to open up to the outside world. In 2002, 87.43 % of the total FDI in China lay in 12 coastal provinces and regions.

China was very successful in attracting a huge amount of foreign direct investment up to five hundred billion US dollars in recent years. It means that one third of all foreign direct investment placed in developing countries came to China and has been doing so since the 1990s. Expanding volume and contract values of investment have started since 2001 as a response to China's prospect to be a WTO member.

Direct foreign investment has played an active role in promoting economic development in China. Foreign investments have opened international channels for sales and purchases that provide a better access for Chinese products to international markets. Foreign investment has to be a pillar of rapid economic growth and help to increase the competitiveness of Chinese industry and optimize the export commodity structure.

Combination of rapid growth, rapid trade growth, and large inflow of foreign direct investment has had significant implications. Foreign direct investment has become the engine of growth in the domestic economy. The interaction among these three elements, the transfer technology and the transfer of management, has been a very important part of China's rapid growth. In addition, exports have also become sources of economic growth in the domestic economy. Moreover, China has become a very important factor in economic growth in the region, for example, trade with South Korea and Taiwan.⁹¹

⁹¹ Op.cit, Nicholas R. Lardy, the Economy Future of China, Speeches in Asia Society, April 29, 2002

IV.6. Conclusion

The booming of China's products as a result of China's economic reform is difficult to understand by some economists, because the economy boom since the 1980s has completely deviated from the standard formulae prescribed by traditional economics. In state owned enterprises, China still operated the traditional system of central planning where the production and price of industry remained under the control of state plans. In terms of industrial output up to the 1990s, the traditional state owned enterprises, compared to the private sector, were still a leading contributor to the increase of China's industrial output.

China's economy is more successful than any other country because China emphasizes the development of an effective commodity market and the creation of a better market environment by improving production and supplies through the improvement of incentive mechanism within enterprises.

Diversities of agriculture and industry have increased Chinese products and volume in the domestic market and in the export sector. Furthermore, science, technology, and education were required as the pillars of agricultural development, supported by the scientific and technical personnel to go to the countryside to encourage the progress of agriculture.

The main focus placed on agriculture was because it was thought that before improving the economy, there had to be better nutrition of human resources. Nevertheless, most Chinese people live in rural areas with farming as their foundation of living. With its huge number of people, China is well able to feed not only all of its population but also 27% of the world population.

In industry, China succeeded in bringing the country to the fourth rank in the world next only to the United States, Japan, and Germany. China's manufacturing industry has existed for more than 20 years. Some people in the world media predict that China will become the "manufacturing centre of the world" and the epoch of "Made in China" will come.

In one side the enormous population gives a burden to China, but on the other side it gives advantages. Many multi-national enterprises are interested to move their manufacturing process to China, because the cheap and proficient Chinese workers and the tremendous processing capacity of China to carry out production for the world market; not to mention that the huge population can become a potential domestic market.

The open door policy has attracted marvelous foreign investment to China. Through foreign investment, China can obtain equipment and technology needed for its modernization. Direct foreign investment has played an active role in promoting economic development in China. Furthermore, it has opened up international channels for sales and purchases that provide a better access for Chinese products to the international market and has become a pillar of rapid economic growth and become the engine of growth in the domestic economy.

CHAPTER V

ECONOMIC REFORM: IMPACT AND PROSPECT

By Cahyo Pamungkas

This chapter is addressed to explaining the impact of China's economic reform. It also explains the relations between China and the international economic institutions such as the World Trade Organization (WTO). As we know, economic reform has a strong relation with historical and political situations and its impact is felt in economic, political, and social aspects. The progress of economic reform in China can be recognized through high economic growth and in international trade. Its economic growth was shown by a quite high figure, namely, 8 % in 1997, and its international trade had a surplus in the same year. China was not trapped in the 1997 economic crisis as experienced particularly by Southeast Asian and East Asian countries, like Korea. The economic development of China cannot be separated from the role of the entrepreneur group in the Communist Party of China.

V.1. China and the Global Economic

China's GDP only ranked seventh when it was measured in current US dollar terms in 2003, but if the Purchasing Power Parity (PPP) indicator were used it already represented the second largest economy in the world.⁹² Based on IMF data, China and ex China (Hong Kong and Macao) contributed 24.5% to the total global trade in 2004. In the same year, total growth of global trade achieved 14%, meanwhile the contribution of China and ex China to the growth was as much as 3.8% and 3.3% respectively, over USA (2.2%) and Japan (1.0%). In the same period, the contribution of the USA to international trade was only

⁹² Maxine Koster and Kathleen Stephansen, 8 December 2004, China and the global economy, <http://research-and-analytics.csfb.com>.

15.4%, while of Japan only 6.5 % and the European Union 18.1 %. China and ex China enjoyed a higher economic growth than the USA, Japan, the European Union, and other countries.

It means that China's economy has challenged developed countries such as Japan and the USA in international trade. The power of China's economy was supported strongly by the ex China countries, such as Hong Kong and Macao. These countries including Taiwan, have become the main supporters of China's economic development since the beginning of the reform period in 1978. The data also shows that China may be considered equal in economic power with other developed countries, such as the USA, Japan, the European Union, and Russia. China's contribution to global trade can be completely seen in the following Table:

Table 5.1
China Contributions to Global Trade 1990-2004

Years	Global Total Trade Growth (%)	Contribution From (%)						
		China	Ex-China	USA	Asia	Japan	EU	Others
2004 trade share		7.0	17.5	15.4	24.6	6.5	18.1	35.4
1990	13.6	0.5	2.1	1.0	2.6	0.7	4.7	4.6
1995	18.9	1.2	4.0	2.1	5.2	1.5	3.1	7.0
2000	12.9	1.5	3.6	2.8	5.1	1.4	1.4	2.2
2001	-3.4	0.3	-1.5	-0.8	-1.2	-0.8	0.4	-1.0
2002	4.4	1.2	0.9	-0.1	2.1	0.0	0.7	1.6
2003	16.5	2.0	2.5	1.1	4.5	0.9	3.4	6.7
2004	14.0	3.8	3.3	2.2	7.1	1.0	3.3	0.4

Sources: Data Stream International Limited, IMF, in Global Economic Special, 8 December 2004.

Now, China is already more important in international trade and it is capable of competing with other developed countries in terms of economic growth, infrastructure development, and other Gross Domestic Product symbols. Besides, China was the world's 4th largest exporter and 3rd largest importer of goods and services in 2003. With the big power of its economy, China can be considered the awakening giant in Asia. According to an interview with Prof Chou Nan Jing, a historian from Beijing University, the People's Republic of China is not the same as the old China when it was ruled by the Qing Dynasty. It was then well known as a weak country, but now China has grown as a modern nation.⁹³ It means that China has developed into a new industrial country in Asia. During the Qing Dynasty, China merely became an object of colonization and was controlled by Colonial countries mainly Britain, Russia, France, and Japan.⁹⁴

An important characteristic of a modern economy is the interdependence among countries in the international economic order. Although there is a dependence of under developed countries on developed countries as described by Sritua Arief (1995)⁹⁵, with all national economies integrated into one world system. Three economic pillars after the end of the Cold War were Japan, the USA, and the European Union. However, now, China has grown to be the fourth pillar. The question is, how sensitive is the global economy to changes in Chinese growth? Many business centers made a prediction on China's economic development, such as the Global Economic Special which assessed the potential impact of China's industrial production as a growth slowdown on the global economy.⁹⁶ The exercise was merely a sensitivity analysis, and does not capture all the multiplier effects stemming from a Chinese policy in response to the current overheating, or determine the shape of the slowdown in

⁹³ Interviewed by Cahyo Pamungkas on 6 June 2005 in Lan Qi Ying, Beijing.

⁹⁴ Ibid.

⁹⁵ Arief, Sritua, Neo-Kolonialisme Ekonomi di Indonesia, 1995, SUARA INDEPENDEN No. 03/1, Agustus 1995.

⁹⁶ Maxine Coster, Lok. Cit.

global growth in the next years.⁹⁷ The data on the Chinese and the global industrial product can be observed in the table below:

Table 5.2
A Slowdown in China and Global Industrial Product Growth in 2005 (in percentages)

Years	China Industrial Product	Global Industrial Product	Global Gross Domestic Product (GDP)	Global International Trade
2001	9.5	-0.2	2.1	-4.8
2002	12.8	2.1	2.6	3.8
2003	16.7	3.9	3.4	15.3
2004	16.2	6.2	4.8	21.5
2005 (1 st prediction)	7	4.4	3.5	17.1
2005 (2 nd prediction)	0	3.4	3.2	14.4
2005 (3 rd prediction)	14	5.4	3.8	19.7

Sources: Data Stream International Limited, IMF, in Global Economic Special, 8 December 2004.

According to table 5.2, China's Industrial Product increased from 9.5% in 2001 to 16.2% in 2004. It was also similar to the growth of global industrial products from -0.2% in 2001 to 6.2% in 2004. The satisfactory development of global industrial production indirectly influenced the global Gross Domestic Product and global international trade since those variables depend on global industrial production. The global GDP grew from 2.1% in 2001 to 4.8% in 2004 and the growth of international trade achieved 21.5% in 2004 from -4.8% in 2001. These pleasing numbers were thought to be the result of successful economic development following the Asian crisis of 1997.

⁹⁷ Ibid.

Although China was experiencing good growth in economic indicators, It was claimed that there was a slowdown in China and in global industrial production.⁷ There were three predictions concerning the slowdown in Chinese industrial production and global Industrial production, growth, and trade. The first prediction was that China's industrial production grew more slowly to 7%. The second prediction claims that there was no growth in 2005, meanwhile the third prediction says that Chinese growth hardly slowed down in 2005. The basis of these predictions gave a benign outlook for 2005 on growth and trade. In the second prediction it was said the global IP would grow slowly to a rate below the 3.9% growth rate reached in 2003, while in the third prediction, a reacceleration to close that year's performance was likely to happen. Global IP and GDP growth would also show a slowdown, even in the worst case prediction.

The impact of the Chinese economy will continue to grow. As the CSFB Emerging Market Strategy team argued in a recent report (The rise of the Chinese consumer, November 30, 2004 in Global Economic Special 8 December 2004), by 2014 the Chinese consumer is predicted to displace the US consumer as the engine of growth in the global economy. The strategy China pursued in the initial stages of economic development was similar to that employed by Japan and Korea in their early development stages.⁹⁸

However, China, it was estimated would benefit from the major globalization trends that took place at the same time, first driven in the 1980s by the removal of barriers to trade and capital, and in the 1990s by the internationalization of the production processes to low cost markets. These would lead China to a sharp rise in trade competitiveness.⁹⁹ For example, changes in trade patterns ensued, with China standing first in global export market share gains between 1985 and 2000 (to 4% from less than 1%), followed by the US, Korea, and Mexico. Another example is the end of the more than 40 years of

⁹⁸ Ibid.

⁹⁹ Ibid.

import quotas on textiles on 1 January 2005, another giant step in that direction, with China set to sharply increase its market share from 16% to 50% in 2002. The above explanation can be seen in the table below:

Table 5.3

USA Clothing Market Shares before and after the End of Quota

Countries	Shares before the end of Quota (%)	Shares After the end of Quota (%)
China	16	50
India	4	15
Other America	16	5
Mexico	10	3
Hong Kong	9	6
European Union	5	-
Rest	40	21

Sources: Global Special Market, 8 December 2004.

Another economic indicator to evaluate China's economic development before and after the application of open economic policies is by using Gross Domestic Product (GDP) per capita to represent people welfare. Although GDP per capita does not exactly depict the people welfare of a certain country, but it can be used to represent the level of production of a certain society that actually can represent a social welfare in general. The development of GDP of China and other countries can be seen in the following table:

Table 5.4
GDP Per Capita

Countries	Period					
	1913-1950	1950-1959	1950-1973	1973-1990	1990-1999	2000-2003
Japan	0.9	4.9	8.1	3.0	0.9	-1.5
China	-0.6	4.2	2.9	4.8	6.4	7.6
Hong Kong	Na	4.6	5.2	5.4	1.7	-1.5
Malaysia	1.5	3.2	2.2	4.2	4.0	4.3
Singapore	1.5	4.9	4.4	5.3	5.7	0.6
South-Korea	-0.4	6.0	5.8	6.8	4.8	5.8
Taiwan	0.6	5.9	6.7	5.3	5.3	1.4
Thailand	-0.1	4.3	3.7	5.5	3.6	0.7
7 averages	-0.4	4.4	3.4	5.1	5.8	2.7
Bangladesh	-0.2	0.9	-0.4	1.5	3.0	1.5
Burma	-1.5	2	2	1.1	3.8	0.6
India	-0.2	2.2	1.4	2.6	3.7	4.6
Indonesia	-0.2	2.7	2.6	3.1	2.1	9.4
Nepal	Na	1.4	1.0	1.5	1.9	2.0
Pakistan	-0.2	2.3	1.7	3.1	2.3	2.8
Philippines	0.0	1.6	2.7	0.7	0.5	0.1
Sri Lanka	0.3	2.6	1.9	3.0	3.9	2.4
8 averages	-0.3	2.2	1.7	2.5	3.0	3.4
Resurgent Asia (15)	-0.3	3.4	2.5	3.9	4.6	3.0
Other Asia	1.8	2.3a	4.1	0.4	1.1b	4.2
Latin America	1.4	1.7	2.5	0.7	1.4	-0.7
Eastern Europe	1.5	1.1	3.5	0.7	-4.8b	14.1
Western Europe	0.8	2.91	4.1	1.9	1.4b	5.3
USA	1.6	2.2	2.5	2.0	2.1	3.0
A=1950-98 B=1990=98						

Sources: Data Stream International Limited, CSFB

According to the data above, China's economic development has grown well. In the period 1913-1950 when ruled by the Republic of China, China achieved negative growth of the GDP per capita of -0.6%. In this period, this country was dominated by political instability such as revolution, war against Japan, and the civil war between the Kuomintang and the Communist party. There was no growth in this period and even the GDP per capita was negative. It means that production was declining. Almost all colonized countries had a negative growth of the GDP per capita except British Malaysia and Singapore that had 1.5% growth. After the Second World War, many countries in Asia and Africa became independent and the world economic order was rearranged.

This impacted on economic recovery for underdeveloped countries. For example, in the period 1950-1959, the eastern Asian countries achieved better growth of the GDP per capita. In this period, China's GDP per capita growth obtained 4.2%, Japan was 4.9%, South Korea was 6%, and Taiwan was 5.9%. Meanwhile South and Southeast Asian countries only achieved less than 3% except Thailand (4.3%). The average GDP per capita growth in the Asian region was 2.2%. Even, the USA only achieved 2.2%, Western Europe only gained 2.9%, and Eastern Europe only 1.1%. It means that China's economy was better than that of most other countries in the period 1950-1959.

After this, in the period 1950-1973, China's economy underwent lower growth of the GDP per capita compared to other countries mainly the countries in Eastern Asia. China only achieved 2.9%, while Japan achieved 8.1%, Hong Kong 5.2%, South Korea 5.8%, and Taiwan 5.3%. In this period, China underwent a production decline on account of political instability resulting from the Cultural Revolution in 1966 and great starvation. But this number was still better than that of resurgent Asian countries that achieved a GDP per capita growth of 2.5%. The better GDP per capita can be understood, because, unlike non communist countries China is a communist state that focused on social welfare and equality among its people.

In the period 1973-1990, China's economy developed better than before. The GDP per capita achieved 4.8% although it was still lower than of

Eastern Asian Countries such as Hong Kong 5.4%, South Korea 6.8% or Taiwan 5.3%. Nevertheless, China was still better than Japan (3.0%), resurgent Asian countries (3.9%), Latin American countries (0.7%), Eastern Europe (0.7%), Western Europe (0.7%), and the USA (2.1%). This better development resulted from the Economic Reform Policy introduced by Deng Xiaoping, as posited in previous chapters. The beginning of 1978 was a new era for China's development; dominated by socialism with Chinese characteristics. The reform has shown the wonderful GDP per capita development mainly in the periods 1990-1999 and 2000-2003 when China achieved 6.4% and 7.6%. These numbers are better than of other countries, even in Eastern Asia (Japan 0.9% and -1.5%, South Korea 4.8 and 5.8%, Taiwan 5.3%), resurgent Asian countries (4.6% and 3%), Western Europe (1.4% and 5.3%), Latin America (1.4% and -0.7%), and the USA (2.1% and 3%).

V.2. China and the World Trade Organization (WTO)

Top Chinese leaders think that WTO accession is the second most important change in China's economic policy, following Deng Xiaoping's reform and open door policies since 1978.¹⁰⁰ The changes will have profound impacts on the future of China's economic development and it encouraged many discussions among academic and policy circles in China concerning with the possible impacts of WTO accession on the China economy.¹⁰¹ Justin Yi Fu Lin (2001) says that some scholars and policymakers are very positive about the accession claiming that any drawback will be overwhelmed by the efficiency gains, encouraging a new impetus to China's reform and economic development. But, other scholars make some criticism of China's accession to

¹⁰⁰ WTO accession and financial reform in china Justin Yifu Lin, *Cato Journal*, Vol. 21, No. 1 (Spring/Summer 2001). Copyright © Cato Institute. All rights reserved. Justin Yifu Lin is Director of the China Center for Economic Research at Peking University and Professor of Economics at Hong Kong University of Science and Technology.

¹⁰¹ Justin Yi Fu Lin, *Lok Cit*.

the WTO since they are worried that China's weak economic base, due to the unfinished transition from a planned to a market economy, will not be able to sustain the tremendous external shocks brought about by the entry.¹⁰²

Accession to the WTO encouraged China to implement some policies as follows. First, China agreed to remove the geographic and business restrictions within five years, allowing foreign banks to set up branches in all cities in China, conduct local currency business, and provide retailing services.¹⁰³ So that, China's financial sector would open up to foreign financial institutions to adapt to WTO accession. It was also suggested that China treat the financial sector as a special industry, be very cautious in liberalizing the sector to foreign competition, and impose many restrictions on the entry and operations of local financial institutions.¹⁰⁴ It was thought that the state owned banks and insurance companies should lose their existing protections, to encourage competition in the financial market.

Second, the financial sector and State Owned Enterprises (SOEs) must be reformed if China is to make the transition from a planned economy to a market economy.¹⁰⁵ The state banks have been burdened by policy driven lending, while their monopolistic nature has resulted in low efficiency. Consequently, the overall quality of China's banking industry is poor and uncompetitive. In fact, China did not have a clear direction of financial reform until 1994. Since then the four state banks have attempted to move their operations toward commercial banking.¹⁰⁶ China has also established a number of other regional and nationwide banks after the WTO accession. The asset values and volume of business of the big four monopolistic banks are no larger than those of other major foreign banks, and their operations and techniques are not as advanced as those of overseas banks.

¹⁰² Ibid.

¹⁰³ Ibid.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

The third is trade liberalization. In terms of the external trade environment, accession to the WTO will surely open up more export opportunities for China's products.¹⁰⁷ Other CGE studies suggest that this is a major benefit of the WTO membership for China, as the textile and clothing sectors are where China's comparative advantage lies.¹⁰⁸ Because of the generalized system of preferences, China can also avoid annual scrutiny of its Most Favoured Nation (MFN) status by the U.S. Moreover, the agreements on subsidies and dumping can discourage export destination countries from taking anti dumping or anti subsidy retaliations unilaterally. Between 1980 and mid 1989, the U.S. conducted sixteen anti dumping investigations against the imports from China (Thunberg 1990:92). In 1994 and 1995, 5 out of 16 anti dumping investigations launched by the European Community were against China.¹⁰⁹

The benefit of taking a part in a world trade forum is more than just promoting trade opportunities.¹¹⁰ According to market principles, the implementation of tight laws and rules in a market system including the trade sector may have been destructive to other sectors. For other countries, admitting China into the WTO means that China will be bound by the rules of the game and this will help to continue economic reform.¹¹¹ Consequently, the international community through the WTO should allow China to produce according to its comparative advantage. More intensified trade and trade related investment will bring larger spill over effects to the economy. Improvement in the variety and quality of imported intermediates can raise the quality of output. More intense competition will boost the productivity of local firms.¹¹²

¹⁰⁷ Warwick J. McKibbin, and KK Tang, Brookings discussion papers in international economics No. 137 The global economic impacts of trade and financial Reform in china, Revised Version: September 1998.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid.

¹¹⁰ Ibid.

¹¹¹ Ibid.

¹¹² Ibid.

WTO membership in 2002 created high expectations for economic reform in China. The most significant impact on the economy will be in the sectors that the Chinese government had protected: the sectors of: agriculture, financial services and telecommunications.¹¹³ In the case of agriculture, for example, the losses in employment, it is feared, will add to the overall threat of rising unemployment in the country. The conversion process may also affect income distribution within China, but it is not clear what the final outcome will be. For example, it may simulate the impact of WTO accession on income disparities in China.¹¹⁴

They conclude that with the dominant role of agricultural trade liberalization, rural households will be the main losers and rural urban economic disparities could increase.¹¹⁵ On the other hand, the impact of globalization would reduce rural urban income inequalities, and, while inequality in the distribution of income within urban areas will rise, in rural areas it will decline.¹¹⁶ Whatever, the final impact of WTO membership may be on sectoral and regional distribution of employment and income, it will have important implications on the design and management of the system of intergovernmental fiscal policies.¹¹⁷

One could argue that the Chinese leadership is simply too weak to resist the push by the American government to join the WTO and, by doing so, open the Chinese economy to American firms and farmers.¹¹⁸ Those who argue that this is the case imply that the potential negative consequences on

¹¹³ Ray Bahl and Jorge Martino Vasquez, Fiscal Federalization and Economic Reform in China, International Studies Program Working Paper 03-13, May 2003, Andrew Young School of Policy Studies, Georgia State University.

¹¹⁴ Ibid.

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Ray Bahl and Jorge Martino Vasquez, Lok. Cit.

¹¹⁸ Satya J. Gabriel, Essay Number 15, August 2001, WTO: A Tool for Growing Capitalism in China, www.mtholyoke.edu.

Chinese firms and farmers are not something the Chinese administration would accept if not for this external pressure.¹¹⁹ The WTO comes with a long list of strings attached, binding agreements that force sovereign governments to change their economic rules of the game.¹²⁰ Given the current mono-superpower status of the United States, it is not difficult to conclude that the growing pervasiveness of these supranational rules of the economic game must be in the interest of American firms.¹²¹ The external intrusions upon the sovereignty of the Chinese government would seem to be something to be avoided, particularly given Chinese sentiment about such external coercion.¹²²

There is opposition within the Party to the growing role of foreigners in Chinese economic life, especially from the conservative communist groups.¹²³

But, it is precisely the continued struggle within the Party over policy that is the reason for the pragmatists pushing for WTO.¹²⁴ They recognize that the long-term struggle within the Party between the reformist and the conservative may be in a relative period is hardly over. The pragmatists or reformist groups may be using WTO as a mechanism to force more rapid and deeper pro-capitalist changes in economic rules over the objections of the conservative groups.¹²⁵ In other words, WTO provides a convenient tool for defeating the conservative groups within the CPC.

The impact of these open-door policy measures on China's trade and inflow of foreign direct investment and loans has been impressive.¹²⁶ Between 1978 and 1990, China's total exports grew almost 18% per year, from \$8.8

¹¹⁹ Ibid.

¹²⁰ Ibid.

¹²¹ Ibid.

¹²² Ibid.

¹²³ Ibid.

¹²⁴ Ibid.

¹²⁵ Ibid.

¹²⁶ Jong H. Park, Oct, 1999, Impact of China's open-door policy on Pacific Rim trade and investment - International Perspective, Business Economics.

billion to \$60.9 billion, the total imports growing from \$9.8 billion in 1978 to \$52.3 billion in 1990, and total volume of trade over the twelve-year period, from \$18.6 billion in 1978 to \$113.2 billion in 1990.¹²⁷ China's economic reforms in form of trade liberalization resulted in impacts as follow:¹²⁸

- **Export Competitiveness.** China relatively low labor costs alone could not have caused this phenomenal growth in exports. China has overhauled its foreign trade system and sought to expand the role of market forces in trade and investment decisions and to promote manufactured exports.
- **Open-Door Policy and Foreign Direct Investment.** Between 1979 and 1990 the cumulative total FDI into China was estimated at \$20 billion. The bulk of this inflow took place following the significant liberalization of the rules governing FDI in 1984. The East Asian NICs, led by Hong Kong, were the major investors in China, accounting for three-quarters of FDI. Foreign-owned firms are attracted to the SEZs and other open coastal cities to take advantage of the relatively low labor cost and the preferential treatment regarding import controls, taxes, foreign exchange retentions, and repatriation of profits.
- **Changing Pattern of Trade and Investment in Asia Pacific.** The phenomenal growth in China's exports and the growth of FDI in China have undoubtedly affected the pattern of trade and investment in the Asia Pacific region and the U.S.-Asia trade relations. China has been able to penetrate successfully the markets of advanced economies, especially the United States.

Thus, in 1991 China's trade surplus with the U.S. was \$12.7 billion, the second largest after Japan's surplus with the U.S. (\$43.4 billion) but ahead of Taiwan's (\$9.8 billion). China has become a potential source of the already serious U.S. trade conflicts with Asia.

¹²⁷ Ibid.

¹²⁸ Ibid.

V.3. Economic Reform and Political Changes

Economic transformation and political changes have a strong relation. It is necessary to understand the historical, cultural, and institutional factors that affect the policies of government officials and the people in economic transformation. Government officials and the important players in the non-government sectors are guided in their behavior by historical and cultural factors. Economic reform in China and Russia has taken different directions partly because of the differences in historical and institutional factors. For example, China's reform in the agricultural sector succeeded because Chinese farmers in 1978 still remembered private farming, the commune system was introduced in China only in 1958.

China's first generation Communist leaders were Zhu De, Zhou Enlai, Chen Yun, Liu Shaoqi, Mao Zedong, Deng Xiaoping. Before 1949, for instance, the illiteracy rate in Mainland China was 80%, and life expectancy was a meager 35 years.¹²⁹ At Mao's death, illiteracy had declined to less than 7%, and average life expectancy had increased to more than 70 years.¹³⁰ In addition, China's population which had remained constant at 400 million from the Opium War to the end of the Civil War, mushroomed to 700 million as of Mao's death. Under Mao's regime, China ended its Century of Humiliation and resumed its status as a major power.¹³¹ Mao also developed China as the industrialized country by following the Soviet Union in early 1950s.

All this change was not without cost both political and monetary.¹³² Efforts of fundamental transformation of economic, governmental, and political organizations caused discontent among some people and in some institutions and were resisted by the political groups that wanted to maintain their privileges in communist economic system. The economic reform leaders made

¹²⁹ The Birth of Modern China: 1644 - present, www.condensedchina.com, 30 August 2005.

¹³⁰ *Ibid.*

¹³¹ *Ibid.*

¹³² History of China, <http://www-chaos.umd.edu>, 22 March 05,

repeated calls for party members and the government to reform their ossified thinking and to adopt modern methods.¹³³ As politics and the economy continued to respond to and change each other, China's reformers had to balance contending forces within and against their reform efforts while maintaining the momentum of Modernizations program.¹³⁴ In doing so, Deng Xiaoping and his associates were faced with several tasks to create unity and support for the scope and pace of the reform program among party members.

Deng's political idioms, such as seeking truth from facts and socialism with Chinese characteristics, were reminiscent of reformist formulations of centuries past and had underlying practical ramifications.¹³⁵ The supporters of Deng held that theory and practice must be fully integrated and they articulated the position that the Marxist-Leninist creed is not only valid but also adaptable to China's conditions.¹³⁶ The ideological conviction that China was still in the initial stage of socialism was reaffirmed at the Thirteenth National Party Congress in October and November 1987 and provided broader ideological basis for continuing the economic reform and development.¹³⁷ This ideological pronouncement also emphasized the reformers' fundamental tenet that since the period of socialist transformation in 1956, there had been numerous leftist errors made in the party ideological line.¹³⁸

As we know that the Great Leap Forward and the Cultural Revolution had produced setbacks in achieving socialist modernization and had made China suffer. So it can be understood that failure of conventional communist campaigns had paved the way for the economic reforms in 1978.

The contrast between the Western and Chinese models of the state economic role are illuminated by the differences among the concepts of a na-

¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Ibid.

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¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Ibid.

¹³⁶ Ibid.

¹³⁷ Ibid.

¹³⁸ History of China, Lok. Cit.

tion-state, the nation and the state, and the nation or the state.¹³⁹ The first concept assumes that there is a positive relationship between the government and society, with the state being the codification of the nation through the constitutional and legal system. The nation and the state points to a situation in which the population accords legitimacy to the central authority while seeking to keep it at arm's length. The third concept, the state or the nation, envisages a sharp distinction between government and people, in which the state may be oppressive and fail to secure popular legitimacy.

The post-1949 communist regime saw the most far-reaching attempts in China's history to bring economic and social life under the centralized control of the state as follow.¹⁴⁰ The first was the central planning system that was established in the 1950s but which never attained the detailed Soviet system. The second was the ideologically sustained mass mobilizations of the Great Leap Forward and the Cultural Revolution, which while ostensibly encouraging local initiatives were nevertheless centrally orchestrated. By the late 1970s, it was seen that both systems of central state control or initiative had failed to provide for sustained economic development.¹⁴¹

Although the country is still ruled by the Communist Party, the current characteristics of China's political and economic systems are becoming very different from those listed in the last paragraph. Since economic reform started in 1978, the Chinese people have continually gained economic freedom. Economic freedom and economic wealth obtained through the market have given the Chinese people much more political power than before. Foreign trade and foreign investment promoted by the open-door policy have increased the contact of the Chinese people and government officials with the outside world. Both ordinary people and government officials are exposed to modern concepts of law and democracy.

¹³⁹ From fiefs to clans and network capitalism: explaining china's emerging economic order Administrative Science Quarterly, Dec, 1996 by Max Boisot, John Child

¹⁴⁰ Max Boisot, John Child, Lok. Cit.

¹⁴¹ Ibid.

In the selection of representatives to China's legislature, members of the People's Congress are indirectly elected by representatives at the level immediately below and public election determines the representatives at the lowest street, district or village level. Unlike the situation before the 1980s, when members of the People's Congress only rubber-stamped legislation proposed to them by the State Council at the direction of the Communist Party, members of the People's Congress today are educated and vote according to their own opinion. Truly democratic public elections are held in villages all over China to elect government officials at the village level, although such elections have not reached higher levels.

The government requires the support of the population to achieve its program of economic reform and development. For example, in the reform of state enterprises it may be necessary to lay off workers, and the government has to consider the possible effect of discontented workers on political stability. Chinese government leaders, just like political leaders elsewhere, consider maintaining their political power to be more important than almost any other objective. They applied force to disperse students occupying Tiananmen Square because they thought its continued occupation was undermining their authority and threatening the survival of the government.

China's historical and cultural tradition is an important determinant of the country's economic reform process and policies. Several historical cultural characteristics are important in this regard. First, the quality of human capital in the form of skilled and hard-working laborers and entrepreneurs has contributed to economic growth and enabled the reform process to succeed to the extent that market incentives alone cannot. Second, Chinese bureaucracy is at the same time a useful vehicle for guiding economic transformation and a hindrance to economic progress.

Third, the traditional way of conducting business through informal social networks and human relations makes it difficult for foreign investors to enter Chinese markets and slows down the introduction of a modern legal system. Fourth, there is an emphasis on the collective welfare of the country

as a whole as compared with the freedom of individuals, making the economy more socialistic. Fifth, there is a sense of nationalism. The current Chinese mentality is a combination of pride and the experience of humiliation.

Communism is dead in the hearts and minds of its people.¹⁴² Chinese people prefer market riches to Marxist dogma. The National People's Congress has amend article 11 of the Constitution and officially recognize that privately owned enterprises are an important part of the socialist, market economy.¹⁴³ The Communist Party of China is weaker now than at any time since 1949 since the economic liberalization that began in 1978 has given more power to the people, and, unintentionally, undercut the Party's power. People have little faith in industrial enterprises or banks run by the state. They know that, regardless of official rhetoric to the contrary, government ownership means party control but that authoritarian approach to economic organization has been a giant failure for all to see.

V.4. Prospects of Economic Reform

There is a major debate in Western economics about the relevance of property rights to economic performance.¹⁴⁴ While the Chinese have explained the post-1978 economic reforms as a move from a bureaucratic to a market-led system of industrial coordination, they have been at pains not to present this as a move toward capitalism and private property rights.¹⁴⁵ Chinese economists and political theorists have distinguished the two Markets and hierarchies are just tools mechanisms for coordinating transactions that with suitable adjustments can each be placed equally effectively at the service of a

¹⁴² James A. Dorn, The Death of Communism in China, <http://www.cato.org>, 30 August 2005

¹⁴³ Ibid.

¹⁴⁴ Max Boisot, John Child, From fiefs to clans and network capitalism: explaining china's emerging economic order Administrative Science Quarterly, Dec, 1996.

¹⁴⁵ Ibid.

socialist or a capitalist order.¹⁴⁶ China is developing a form of capitalism, nevertheless argued that this would not be based on Western institutions but depend on very much on adaptation by a state that continues to regulate property rights.¹⁴⁷

While state enterprises in China are officially owned by the whole people, government being the de facto representative of their owners, the intention of the economic reformers has been to separate public administration from business management by decentralizing powers of enterprise decision making to the latter through the Contract Responsibility System.¹⁴⁸ There is a juxtaposition in China of an emergent form of quasi-capitalism that incorporating important aspects of governmental patronage, and marketing.¹⁴⁹ So, we can understand that from the point of view of conventional Western thinking, it will inevitably generate certain fundamental tensions between the interest of market and socialism that are characteristics of China's economic reforms.

As we know that, a Socialist market economy with Chinese characteristics is the official term for the economy of the China. Starting in the early 1990s the government intended to retain ownership of heavy industry, entry, and infrastructure. China gradually made a transition to a system in which all resource allocations are made on the basis of prices, and most of the means of production are in private hands. They have been particularly aggressive in the pursuit of socialism with Chinese characteristics, even to the point of admitting entrepreneurs to the Communist Party. Therefore, China today is generally regarded as being capitalist de facto, with just a little higher degree of government control. The Chinese government also still continues to maintain

¹⁴⁶ Ibid.

¹⁴⁷ Ibid

¹⁴⁸ Ibid.

¹⁴⁹ Ibid.

Marxism and communism to strengthen the legitimacy of the Communist Party of China.¹⁵⁰

However, the Communist Party is said to have lost its reputation in recent years on account of corruption problems, despite tens of thousands of punitive actions against corrupt party leaders at all levels.¹⁵¹ The current Chinese system combines both socialism and capitalism: the inherent corruption problems of a vast powerful, but low paid bureaucratic establishment, plus exploitation of workers in some places on a large scale.¹⁵² This problem occurs in both in Capitalist and Communist countries. For example, Indonesia and the Philippines that included democratic countries also underwent the corruption.

The most important issue in the future concerns the China-Taiwan relation. Chinese leaders may have to go to war to avoid massive loss of face, and even their positions if Taiwanese declare full independence. Indeed, any military or economic conflict between Taiwan and China would be massively destabilizing to the economies of both places.¹⁵³ Since much of the production is concentrated in China and Taiwan, shortage of computer chips could also

¹⁵⁰ Communism is the doctrine of the conditions of the liberation of the proletariat. The proletariat is that class in society which lives entirely from the sale of its labor and does not draw profit from any kind of capital; whose weal and woe, whose life and death, whose sole existence depends on the demand for labor – hence, on the changing state of business, on the vagaries of unbridled competition. The proletariat, or the class of proletarians, is, in a word, the working class of the 19th century. There have always been poor and working classes; and the working class have mostly been poor. But there have not always been workers and poor people living under conditions as they are today; in other words, there have not always been proletarians, any more than there has always been free unbridled competitions.

¹⁵¹ Uncertainties in china's economic prospects and the broader problem of global imbalances, a presentation by Ambassador Richard McCormack 13 April 2005, www.csis.org.

¹⁵² www.csis.org Lok. Cit

¹⁵³ Ibid.

impose real dislocations in the broader global economy, should any conflict over Taiwan get out of hand.¹⁵⁴ Prof Zhou Nan Jing in his interview said that he doubt that China will resolve the problem by using a military approach since China's economic reform is dependent on Taiwanese support.¹⁵⁵

Another issue is relationship between Japan and China. Part of this, is related with the legacy of the Second World War and the textbook treatment of these historical issues in each country.¹⁵⁶ Japan and China are economic and political rivals in Asian region that some developing countries depended on these countries. There are also conflicting territorial claims over fisheries and potentially rich resource deposits under the seabed.¹⁵⁷ China's economic growth is financing a military build up that is alarming to many countries including Japan and Taiwan. These disturbing trends are one more potential uncertainty in the economic and political outlook for the region.¹⁵⁸

The last issue is about North-Korea China relations. They are two countries in geographic proximity which share a history and ideology of communism. North Korea has been heavily influenced by what has occurred in China.¹⁵⁹ It means that North Korea has often copied a change in policy or innovation by China though this has by no means all been one way. The North Korea Flying Horse movement is comparable to China's Great Leap Forward program and some programs of the North Korean collectivisation were copied by China.¹⁶⁰ Up to the late 1980s North Korea regarded the Soviet Union as a more strategic partnership than China. But now China is becoming the strategic partner and gives political support to North-Korea mainly in dealing with

¹⁵⁴ Ibid.

¹⁵⁵ Interview Cahyo Pamungkas with Prof. Zhou Nan Jing in Beijing on 7 June 2005.

¹⁵⁶ Ibid.

¹⁵⁷ Ibid.

¹⁵⁸ Ibid.

¹⁵⁹ James Graham, A Comparison of Chinese and North Korean Communism up to the 1980s, www.historyorb.com.

¹⁶⁰ Ibid.

the pressures from Western countries. Thus to a certain degree North Korean communism has been supported by Chinese since the Korean War until now.

There are indications that not only are capitalism and self-employment becoming deeply rooted in the Chinese economy but that, as indicated above, the prevalent form of capitalism has shifted from a state to a private form.¹⁶¹ As private capitalism grows, it creates a dynamic that fosters further growth, displacing the state variant form of capitalism as well as alternative class processes including self-employment.¹⁶² We can say that state capitalism is the marriage of capitalism and state-ownership which gets to the heart of the material difference between state and private capitalism, which is not simply ownership but the issue of relative autonomy.¹⁶³ A state capitalist firm is simply a component in a larger bureaucratic structure with objectives and activities constructed to serve and support the larger bureaucracy.¹⁶⁴ On the other hand, it can be said that the state capitalist firm enters into agreements only if those agreements are consistent with the dictates of the bureaucracy.

The original motivation for the Communist Party of China was to take a pro-capitalist approach that generate sufficient surplus value to speed-up the modernization of Chinese industry, the military, research and development, and agriculture.¹⁶⁵ The fact is that private capitalism has produced relatively large increases in surplus value, with average annual growth rates approaching 10% and has provided the main evidence for the correctness of the pragmatic conservative approach and reinforced the CPC leadership.¹⁶⁶

¹⁶¹Satya J. Gabriel, China Essay Series, Essay Number 18, June 2003, The Transition from State to Private Capitalism in China: The Network of Distributive Class Payments, Modernization, and Growth of the New Social Strata, www.mtholyoke.edu opened 30 August 2005.

¹⁶² Ibid.

¹⁶³ Ibid.

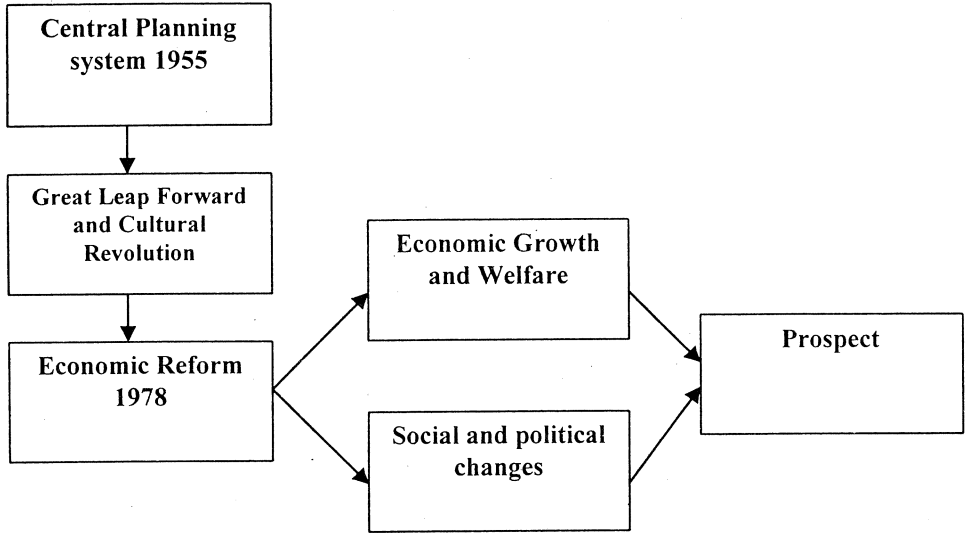
¹⁶⁴ Ibid.

¹⁶⁵ Ibid.

¹⁶⁶ Ibid.

V.5. Conclusion

All of the explanations above can be described by the following diagram:



From the above explanation, it can be concluded that economic reform as respond to the failure of the Central Planning System implemented in 1955 and Great Leap Forward undertaken in 1958 had impact on great economic and social changes. The economic changes represented in economic growth and surplus in trade led China to emerge as a superpower in economic. The acknowledge for Chinese entrepreneurship in social communist order such as the three representative theories of President Jiang Jemin indicated that social changes are going on in China. The economic reforms also enable civil-society, party administration, and government officials to implement a limited political reform in the framework of The Communist Party of China (CPC). These changes resulted in a high political stability and economic growth. With power in economic, China can replace Russia in the international economic and political order.

CHAPTER VI

CONCLUSION AND RECOMMENDATION

The sluggish economic growth and the damage caused by the political struggle of the Great Leap Forward (1958-1960) and “Cultural Revolution” from 1966 to 1976 created serious problems in China in the late 1970s. It was a new experiment for China, and its implementation was marked by serious economic setback and great social chaos, poverty, huge unemployment, slowness in economic and development activities, particularly during the Great Leap Forward and the Cultural Revolution. In economic reform, China tried to apply policies that more affected economic conditions rather than political conditions.

China followed the “trial and error” approach for the correction. Starting 1979, China began a series of “trial and error” economic reforms. This gradual change in policy is the first characteristic of China’s economic reform. The second characteristic is that the rural reform came before the urban reform in the early stages of economic transformation. The third is China’s “open-door” policy. The government opened most coastal cities for foreign investments. The fourth is the coexistence of socialism and capitalism.

Based on Mao’s perspective, that the modern socialist society should be attained through a transformation process, which occurred in the rural areas. As a result, agricultural development, based in the rural areas, became a precondition for the development of the People’s Republic of China in the 1949 - 1978 period.

China’s Economic reform

China’s economic reform toward a market-oriented economy began in 1978 and has been recognized as essentially successful. China had introduced successful market-oriented privatizing reforms in the presence of communist

dictatorships, which show no signs of weakening. China's economic growth and institutional transition in the last quarter of the 20th century are both regarded as successful. China's economic growth qualifies as a miracle in terms of both magnitude and speed. Its institutional transition before 1978 adopted a gradual approach contrasting with the shock therapy adopted by the former Soviet Union and Eastern European countries; which were experiencing many failures in developing solid economic and political systems.

The core of China's economic reform was to exploit its comparative advantage. The basic contents of the economic reform were the transformation from the command economy to the market economy, focusing on the development of the light industry, change from a closed economy to an open economy and allowing foreign direct investment and private enterprise.

There were four advantages in the process of China's economic reform. First, communism was a "foreign" system that China imported from the Soviet Union. The society had been deeply involved with this system only from 1953 to 1978. It would therefore be easy for China to resume the market economic system, which existed before the 1949 revolution. Second, China as we already know has a long history of high civilization. The open market in China occurred several thousand years ago. The commercial activities such as those in the current market economy were common in China's history. These traditions were helpful for China in the transition. Third, the experiences of the successful economic development in China's regions, such as Taiwan, demonstrated a new road for China's economic reform. Fourth, Hong-Kong, Taiwan, and other overseas Chinese provide Mainland China with a vast amount of capital and technology.

Behind The Economic reform

We know that economic reform was one of the steps in the historical development of the People's Republic of China. Before the reforms, the People's Republic of China was known as a communist country applying an

autocratic development strategy that came from the principle of self sufficient principle. This development model, which was introduced by Mao Zedong, is also known as the socialist revolutionary development model. One of the characteristics of this model was that the development of the agricultural sector was put in the top position. Based on Mao's perspective, a modern socialist society should be attained through the transformation process occurring in the rural area. As a result, agricultural development, based in the rural area, became a precondition for the development of the People's Republic of China in the 1949-1978 period.

The logic, constructed by Mao, was basically that the capital from agricultural sector could not be taken from the rural areas to supply the development of industrial sector in the urban areas. That capital should be kept in the rural community to emend nutrient, health, social services, and education procurement for the farmers. Agricultural development was more prioritized than the development of heavy industry to increase the accumulation of social assets. Every pressure towards heavy-industry sector would adversely affect the development of the agricultural sector. This policy was conducted by developing a large agricultural venture system as vast as 500-1000 Ha for every production unit. Besides, the land-reform policy was also conducted to omit relation between feudalism and capitalism production as heir of the old structure.

After 1955, the People's Republic of China's government changed its development strategy by Great Leap Forward Policy. This was conducted to attain high economic growth by putting pressure on the industrial sector development. Liu Sao Xi and Deng Xiaoping pioneered this development model which was conducted by a centered planning system controlled by the bureaucrats to coordinate the work and to shift responsibility rationally.

This policy was conducted by forming people's communes in the rural areas. These communes were designed to make the transition from socialism to communism possible, even though this policy showed an apposite result from that expected by Mao. The revenue from the agricultural and industrial

sectors was becoming less. The people' communes did not show the productivity escalation, meanwhile the private and individual ventures were forbidden by the state.

Liu Sao Xi reapplied the socialist development system and increased the Great Leap Forward program. Intensive usage of materials was allowed to increase citizen work-productivity. The experts, technicians, and intellectuals were acknowledged in contributing ideas and regained their positions in society. Mao himself contended that the convictions of people' ideology and prestige should be emended to prevent the death of revolutionary spirit and the reappearance of capitalism as an impact of on the recovery program after the Great Leap Forward program. This era (1966-1976) was known as Cultural Revolution era during which the application of the development model was based on political mobilization instead of on technocratic principles.

The Cultural Revolution resulted in the decrease of the production sector in 1967, which was only recovered in 1969. During 1966-1976 period, there was chaos everywhere. Mao's development strategy gave a higher level of even-distribution than in any developing country. Besides, the social cost was too much, indicated by the abundance of human victims.

After Mao and Zhou Enlai died in 1976, Deng Xiaoping and Hua Guofeng conducted the modernization by accepting four principles: the People's Republic of China as a socialist country; The people were democratic dictators; The Communist Party of China (CPC) was supreme and Maoism was the state ideology.

Economic reform of the People's Republic of China could be administrated because of the supports from four intertwining factors, both internal and external factors. Those factors are:

1. The conversion of the leadership structure in the People's Republic of China after the Mao Zedong era affected the stronger power of the reform group under the direction of Deng Xiaoping.

2. The Mao Zedong development strategies, were radical and preceded political development, causing a lot of sacrifice and regression.
3. The choice to prioritize economic development as an effort to increase welfare standards of the society.
4. The development of global politics showed a more dangerous threat from the superpower countries and the prime enemies of the People's Republic of China.

Steps of Economic reform

Economic reform policy was started when Deng Xiaoping acquired power in 1978 through the third session of 11th National Congress of the Communist Party of China. This policy was conducted by re-conjugating communism to give a new direction to the economic policy and the government of the People's Republic of China in the future. The basic essence of socialist theory, based on Deng Xiaoping's thought, was to be in the freedom and in the development of productive power (Al Mandari, 2003) and the failure or success criteria of a party should be returned to the people, whether they are satisfied or dissatisfied, like or dislike the party.

The People's Republic of China began to apply economic reform on the market economy along with socialist theory and doctrine. The result was that a mutual-espousal relation between political stability as a product of the communist governance system and economic growth as a product of the market economy system was constructed.

The development plan using the market economy was divided into three stages during 24- year period: The Initiating Stage (1978-1984), The Exploring Stage (1984-1991), and The Standardizing Stage (1992-now). Before the economic reforms, almost all of the enterprises in the People's Republic of China belonged to all the society that formed states enterprises. In this period, there were several enterprises that were possessed collectively by society, but

the management was similar to that of state enterprises. This was comprehensible since the economic system conducted before the reform era was a planned economy system. In this economic system, state enterprises did not emphasize their function to gain the benefit and were not managed independently by the directors or the owners of the enterprises. People who had a role in enterprise decision and policy making were the CPC and the People's Republic of China's government, so that the enterprises only functioned as production units. Those enterprises only ran the production while the government decided their products and prices. The government also conducted the selling and receiving function and decided on the benefit distribution of the enterprises. As a result, enterprises became dependent and experienced quite low product efficiency.

This new system was publicly known as the market economy system where the production applications, such as enterprises, belonged to a certain class in society. Those enterprises not only functioned as technical production units, but also had the autonomy to plan, conduct, and sell their products. The enterprise's goal was to get benefit, which also became the motivation in the production process. Furthermore, the enterprise also had the authority to decide the benefit distribution to the workers and the managers, to give production bonuses, to hire/fire the worker, etc. These were enacted by The State Council in May 1984 that stipulated the autonomy of state enterprise in ten scopes: production and operation; programming; product sales; pricing; material procurement; use of funds; disposition of property; structuring; personnel and labour; distribution of wages and bonuses; and the utilization of a combination power.

This pushed the collectively owned and individually owned enterprises in 1980 to gain their total investment in fixed assets of up to 4.6 billion Yuan and 11.9 billion Yuan, respectively, or increased 150.4% and 49.8%, respectively, compared with a year before. Meanwhile the state-owned enterprises declined by 10.5%. This condition was followed by the decrease of the government revenue to the GDP by 5.5%, indicating the decline of centralisation

in the era of decentralisation (China Statistical Year Book, 2004). In this period, China also announced its “Coastal Development Strategy”. In 1979 China initiated the Development of the Special Economic Zones (SEZs) and in 1980, China began its production strategy by increasing specialization in exports of labour-intensive products.

In 1984, the CPC 12th Congress initiated the economic reform policy known as “the whole people, collectives and individuals to go all out”. This policy encouraged all economic sectors, whether they belonged to individuals or society, or even foreigners to cooperate in building contractual/equity joint ventures or associations. Thus, state enterprises were allowed to be in existence or to merge with individual or public enterprises. The CPC 13th Congress in 1987 proposed the mergers of small-scale state enterprises and share system with the public enterprises. The government also ratified the Enterprise Law in 1988 that regulated state enterprises. In addition, the government also eased the regulation to protect private enterprises with such policies as the Interim Regulation for the Administration of Urban and Rural Individual Industrial and commercial Businesses, the Law of Foreign Invested Enterprises, and the Provisional Regulations of Private Enterprise.

The 12th CPC Congress also ascertained the development of reform from the rural areas to urban areas and state enterprises as the central national reform program. During this period, the growth average of state enterprise output sum per year gained 8.3%, meanwhile private enterprises gained 23.9%, and public enterprise gained 19.7%. While, growth average of individual enterprise output in urban and rural areas per year amounted to 45.4% and the growth of the industrial sector amounted to 47.3%. In 1991, private enterprise output contributed 43.8% to the total production. These revealed that the efficiency level of private enterprises was higher than that of state enterprises still managed by government.

Since 1992, economic reform in the People’s Republic of China has attained the standardizing stage. During this period, the State Council eased some policies giving a wider authority to the state enterprises, such as Rules

for Shifting the Operational Mechanism of the Industrial Enterprises owned by the whole people. There are at least 14 rights of state enterprise: decision-making in production and operation; price-setting for products and labor; selling of products; material purchasing; import and export; investment decision; disposition of retained bonuses; dispositions of property; decision on joint operation or mergers; labor employment; personnel management; distribution of wages and bonuses; internal structuring; and refusing apportioning. As a result, state enterprises were treated just like public enterprises, which assured profit and loss and existence regardless of government subsidies.

To complete the on going economic system as an umbrella for the whole development process and the economic reform program, the CPC Congress ensured the establishment of a socialist market economic system. The system basically emphasizes that the market had a fundamental role related to the regulation of economic resources under state control. The state created some conditions so that all economic sectors could participate in the competitive free market based on equal opportunity. As a consequence, all the enterprises were to be treated equally with no discrimination against certain groups. In December 1993, the Company Law was ratified. It stated that the enterprises funded by different investment corporations were to be treated equally before the law. The 15th CPC Congress in 1997 ascertained that private enterprises were important components in socialist market economic system. The 1999 constitution amendment proclaimed that private enterprise status and role were important in the People's Republic of China's economic structure.

In September 1999, the CPC Congress also revealed several important issues related to the transformation and development of state enterprises to become modern enterprises. One of the issues was the diversification of share ownership involving foreign-invested corporations. In April 2001, The State Commerce and Economy Commission and Labor/Social Assurance Minister ascertained the Opinions on Deepening the Reforms of the Internal Personnel, Labor and Distribution systems of State enterprises. Those rules stated that the enterprise administration stage was cancelled; enterprises director did not

have to be responsible to the government administration official anymore. The director of an enterprise could be elected by the shareholders or by means of open-election and could be recruited from all faction in the society.

In 1994, there were 33,000 joint venture enterprises in the People's Republic of China. The government privatized 100 state enterprises in November 1994. The state enterprises were able to develop into independent entities in market mechanism and became independent of the government. The enterprises consisted of shareholders assemblies, director councils, commissary councils, and managerial staff. Each had different job and authority, in policymaking, policy implementation, supervision, and policy execution. From 1991 to 2001, the growth average levels of public and state merger enterprises gained 17.3%; public enterprise's output gained 24.3%. In 2001, public enterprise's output gained 78.3% from the total while in 1991 it had gained 45.8%.

Those policies were supported by the people of China and were acknowledged as the continuation of a historical process that commenced with the Chinese revolution and reconstruction process. The result of Deng Xiaoping's reform program can be seen mainly in two main issues; the social market economic system and idea liberalization. In this context the economic system was basically a regulation based on the free market mechanism, directed by the government to assure equity for all people.

The effect of Economic reform

The economic reform of the People's Republic of China has had some effect on economic growth and has strengthened the position of the People's Republic of China in the global economic structure. The People's Republic of China has become a country with 7-8% economic growth on average in the last ten years. This quite significant progress was also supported by the ability to attract investment and encouraged the People's Republic of China to become one of the centers of global economy. In 2000, the People's Republic of China

economy grew for 8% with 27.9% for export and 35.8% for import (Sutarjo, 2003). In 2001, when many countries were experienced economic decline, the People's Republic of China was still able to grow by 7.3% with 6.8% for export and 8.2% for import. This placed the People's Republic of China in 9th position in the world economy (Sutarjo, 2003).

The success of the People's Republic of China reform program was supported by several factors (Sutarjo, 2003). First, it was conducted carefully, in phases, pragmatically, and patiently. The reform course was first set up to become a framework for policy implementation. Second, the success of the program was also followed by other reforms in the areas of governance, culture, politics and law.

Talking about the contribution of national investment, most of the investments (60%) were made by state-owned enterprises where the government spent 30% of the state enterprises budget and the rest of the investments (40%) was made by private business (John D. Lang Lois, 2000). Among those private enterprises there were 15,000-20,000 army-owned enterprises that were subsidized by the government. They endeavored in many areas such as hospitals, husbandry, pharmacies, airways, hotels, textiles, real estate, etc. The abundance of those kinds of enterprises affected the assumption that these big businesses were coming from the powerful bureaucrats or the CPC elites class and their cronies.

Related to the reforms of the People's Republic of China, Willim Overholdt (1994) explained the differences of approach and reform strategies applied by the People's Republic of China and those applied by the Soviet Union. The People's Republic of China prefer taking examples of reform and economic development that had previously been made in the neighboring countries, such as South Korea, rather than in other communist countries. The People's Republic of China together with South Korea, Taiwan, Hong Kong, and Singapore had become role models for the economic development of Asian countries.

The development model in the Soviet Union ignored reform in agricultural sectors and merely depending on heavy industry thus being un-attracting to foreign investment. Meanwhile, the People's Republic of China gave priority to industrial sectors in which the government investment was still limited so that it was able to encourage vast economic growth. The People's Republic of China also boosted productivity escalation of the agricultural sectors and at the same time returned agriculture land to the farmers. Beside that, a program to attract foreign investment and to push small industries had become a part of the reform policy.

Those differences of development strategy yielded significant output differences in a six year period of reform. The People's Republic of China showed greater and greater GNP growth from 1980 to 1986 amounting of 7.8% to 12.7%. While the Soviet Union experienced decreases from 2.6% to -18.2% in the same period. The complete description can be seen on the following table:

Table of the People's Republic of China and the Soviet Union GNP's Growth in the First Six Year of Reform (in Percentages)

No.	Year	The People's Republic Of China	Year	The Soviet Union
1.	1980	7.8	1986	2.6
2.	1981	4.5	1987	1.7
3.	1982	8.7	1988	4.1
4.	1983	10.3	1989	-2
5.	1984	14.6	1990	-6
6.	1985	12.7	1991	-18.2

The success of China's economy, compared to that of other countries was because China emphasized the development on an effective commodity market and a better market environment by improving production and supply through the improvement of the incentive mechanism within enterprises.

Agricultural and industrial diversities have increased Chinese products and volume in both the domestic market and the global market. Furthermore, science, technology, and education were required as the pillars of agricultural development, supported by scientific and technical personnel to go to countryside to encourage the progress of agriculture as well as the financial side and investment in the agricultural system.

Focusing mainly on the agricultural side was the best plan for China because before going to a healthier economy, they had to provide better nutrition for their human resources. Besides, most of Chinese people live in rural areas with farming as their foundation for living. With its huge population, China can feed their people and can feed 27% of the world population.

From industry, China gained succeeded in bringing the country to be the fourth ranking in the world next only to the United States, Japan, and Germany. China developed quickly in the manufacturing industry over more than 20 years. Some people of the world media predict that China will become a "manufacturing center of the world" and an epoch of 'Made in China' has come."

Enormous population is a burden to China, but it also has advantages. Many multi-national enterprises are interested in moving their manufacturing to China, because of the cheap and efficient Chinese workers and the tremendous processing capacity in China to carry out production for the world market; not to mention that the huge Chinese population can become a potential domestic market.

The open door policy has attracted significant foreign investment to China. Through foreign investment, China can obtain the equipment and technology needed for China's modernization. Direct foreign investment has played

an active role in promoting economic development in China. Furthermore, it has opened international channels for sales and purchases that provide a better access for Chinese products to international markets and has to be a pillar of rapid economic growth and the engine of growth in the domestic economy.

In the global economy, China's GDP only ranked seventh when it was measured in current US dollar terms in 2003, but if the purchasing power parity (PPP) indicator is used, it already represents the second largest economy in the world. Based on IMF data, China and ex-China (Hong Kong and Macao) contributed 24.5% to the total global trade in 2004. In the same year, total growth of global trade achieved 14%, meanwhile the contribution of China and ex-China to the growth was as much as 3.8% and 3.3% over USA (2.2%) and Japan (1.0%). In the same period, the contribution of USA to international trade only achieved 15.4%, Japan only was 6.5% and European Union 18.1%. China and ex-China enjoyed a higher economic growth than the USA, Japan, the European Union, and other countries. It means that China's economy has made challenges in international trade from developed countries such as Japan and USA. Now, China has grown to be the fourth economic giant, after Japan, USA, and the European Union. The power of China's economy can be supported strongly by ex-China countries such as Hong Kong and Macao.

China becomes a member of the WTO

Top Chinese leaders thought that accession to the WTO was the second most important change in China's economic policy, following Deng Xiaoping's reform and open door policies since 1978. The changes would have profound impact on the future of China's economic development and encouraged many discussions in academic and policy circles in China concerned with the possible impact of the WTO accession on the Chinese economy.

Accession to the WTO accession encouraged China to implement some policies as follows. First, China should agree to remove the geographic and business restrictions within five years, allow foreign banks to set up branches

in all other cities in China, conduct local currency business, and provide re-tailing services. Second, China's financial sector should be opened up to foreign financial institutions to adapt to WTO accession. Third, the financial sector and state-owned enterprises (SOEs) must be reformed if China is to make the transition from a planned economy to a market economy. The state banks have been burdened by policy lending while their monopolistic nature has resulted in low efficiency. Consequently, the overall quality of China's banking industry is poor and uncompetitive. Fourth, was trade liberalization. In terms of the external trade environment, accession to the WTO would surely open up more export opportunities for China's products. Other CGE studies suggested that this would be a major benefit of WTO membership for China, as the textile and clothing sectors were where China's comparative advantage lay.

WTO membership in 2002 created high expectations for economic reform in China. The most significant impact on the economy would be in the sector that the Chinese government had protected, the sectors of: agricultural, financial services and telecommunications. China economic reforms in trade liberalization resulted in impacts as follow:

- **Export Competitiveness.** China's relatively low labor costs alone could not have caused this phenomenal growth in exports. China has overhauled its foreign trade system and sought to expand the role of market forces in trade and investment decisions and to promote manufactured exports.
- **Open Door Policy and Foreign Direct Investment.** Between 1979 and 1990 the cumulative total FDI into China has been estimated at \$20 billion. The bulk of this inflow took place following the significant liberalization of the rules governing FDI in 1984. The East Asian NICs, led by Hong Kong, were the major investors in China, accounting for three-quarters of the FDI. Foreign-owned firms were attracted to the SEZs and other open coastal cities to take advantage of the relatively low labor costs and the preferential treatment regarding import controls, taxes, foreign exchange retentions, and repatriation of profits.

- Changing Pattern of Trade and Investment in the Asia Pacific. The phenomenal growth in China's exports and the growth of the FDI in China have undoubtedly affected the pattern of trade and investment in the Asia Pacific region and the U.S.-Asia trade relations. China has been able to penetrate successfully the markets of advanced economies, especially the United States. Thus, in 1991 China's trade surplus with the U.S. was \$12.7 billion, the second largest after Japan's surplus with the U.S. (\$43.4 billion) but ahead of Taiwan's (\$9.8 billion). China has become a potential source of the already serious U.S. trade conflicts with Asia.

Notes from China's Reform

China's historical and cultural tradition was an important determinant of the country's economic reform process and policy. Several historical cultural characteristics were important in this regard. First, the quality of human capital in the form of skilled and hard-working laborers and entrepreneurs contributed to economic growth and enabled the reform process to succeed to the extent that market incentives alone could not. Second, Chinese bureaucracy was at the same time a useful vehicle for guiding economic transformation and a hindrance to economic progress. Third, the traditional way of conducting business, through informal social networks and human relations, made it difficult for foreign investors to enter Chinese markets and slowed down the introduction of a modern legal system. Fourth, there was an emphasis on the collective welfare of the country as a whole compared with the freedom of individuals, making the economy more socialistic. Fifth, there was a sense of nationalism. The current Chinese mentality is a combination of pride and the experience of humiliation.

As we know that, the Socialist market economy with Chinese characteristics was the official term for the economy of China. Starting in the early 1990s the government intended to retain ownership of heavy industry, entry the economy and the infrastructure. China gradually made a transition to a

system in which all resource allocations are made on the basis of prices, and most of the means of production are in private hands. China has been particularly aggressive in its pursuit of socialism with Chinese characteristics, even to the point of admitting entrepreneurs to the Communist Party. Therefore, China today is generally regarded as being de facto capitalist, with just a small degree of government control. The Chinese government still continues to maintain Marxism and communism to strengthen the legitimacy of the Communist Party of China.¹⁶⁷

Recommendation

- China's reform and modernization was done gradual and careful through a good planning and implementation.
- First reforms in the Chinese economic reform process were in agriculture in which the majority of Chinese are involved. Besides, good nutrition of society is the basic need for human resources to develop China.
- Consistence in law and policies are the significant factors in building the belief of society in the government. Thus, good policy makers and their reliability have constructed a loyal society as the economic actor and the market object, and stabilized conditions in economics and politics.

¹⁶⁷ Communism is the doctrine of the conditions of the liberation of the proletariat. The proletariat is that class in society which lives entirely from the sale of its labor and does not draw profit from any kind of capital; whose weal and woe, whose life and death, whose sole existence depends on the demand for labor – hence, on the changing state of business, on the vagaries of unbridled competition. The proletariat, or the class of proletarians, is, in a word, the working class of the 19th century. There have always been poor and working classes; and the working class have mostly been poor. But there have not always been workers and poor people living under conditions as they are today; in other words, there have not always been proletarians, any more than there has always been free unbridled competitions.

- Clean government by law enforcement has given the stability in social and politics. The unity and harmony among government bureaucrats who are consistent and reliable in their responsibilities had made the implementation of economy programs run appropriately and faster.
- Clean government by law enforcement has given stability in social life and politics. The unity and harmony among government bureaucrats who are consistent and reliable in their responsibilities made the implementation of economic programs run appropriately and quickly.
- The Socialist market economy by giving a chance to the enterprises to run their companies under state control, created a healthy competition among enterprises.
- Great attention to the development of agriculture by providing many facilitates and support, has made a big contribution to the development of the Chinese economy and support for other economic factors.
- The incentive system in industry has created good support for middle and big enterprises to develop their capacities.
- Good infrastructure, social management, law and policy enforcement, clean government, stability in social life and politics etc, have given a big reason for huge foreign investment to come to China rather than to other countries in Asia and is a suitable model for others including Indonesians to study from China.
- Trying to develop research and development as a think tank in science and technology for supporting the development of agriculture and industry as the economic pillars is not only important for Chinese society but also has potential for exports.
- Giving great attention to human resources in skills and education by readjusting the educational system to provide useful potential human resources and is a big step to support economic reform.

- The long history of China has planted a sense of nationalism in Chinese society (even those overseas) that motivates them to be collectively responsible for reform in their country as well as to maintain and to keep up the quality and the magnificence of their country.

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Interviewed by Cahyo Pamungkas on 6 June 2005 in Lan Qi Ying, Beijing

EXECUTIVE SUMMARY

**THE IMPACT OF ECONOMIC REFORM
ON THE ECONOMIC DEVELOPMENT
IN THE PEOPLE'S REPUBLIC OF CHINA
(1978-2003)**

**DAMPAK REFORMASI EKONOMI
TERHADAP PERKEMBANGAN EKONOMI
DI REPUBLIK RAKYAT CINA (1978-2003)**

**DAMPAK EKONOMI PASAR
TERHADAP PERKEMBANGAN KOMUNISME:
Studi Reformasi Ekonomi di Republik Rakyat Cina (1978-2003)**

Reformasi Ekonomi Cina

Reformasi ekonomi Cina dimulai pada tahun 1978 dan diakui membawa keberhasilan hingga saat ini. Sistem ekonomi pasar telah memberikan kemajuan dan percepatan pembangunan Cina dalam seperempat abad. Perubahan dari sistem ekonomi tertutup ke sistem ekonomi terbuka yang memfokuskan pada pembangunan pertanian, industri, penanaman modal asing, dan pertumbuhan perusahaan swasta, telah berhasil mengangkat Cina sebagai raksasa ekonomi di Asia.

Ada empat keuntungan dalam proses pembaharuan ekonomi Cina, pertama, sistem komunisme sebagai sebuah sistem “asing” yang diambil dari Republik Sosialis Soviet yang tertanam pada masyarakat Cina, hanya berlangsung selama tahun 1953 hingga 1978, sehingga menjadi lebih mudah untuk memperkenalkan sistem ekonomi pasar yang menjadi ciri khas negara liberal. Kedua, sebagaimana kita ketahui, Cina memiliki sejarah peradaban yang panjang. Ekonomi terbuka telah ada beberapa ribu tahun yang lalu, dimana kegiatan perdagangan telah berlangsung pada sejarah Cina dengan dikenalnya jalan sutra. Hal inilah yang telah membantu proses pembaharuan Cina. Ketiga, pengalaman keberhasilan pembangunan ekonomi pada wilayah bagian Cina seperti Taiwan telah memberikan arah dan keinginan bagi pembaharuan daratan Cina. Keempat, Hong Kong, Taiwan, dan perantaraan Cina telah memberikan sumbangan yang besar bagi daratan Cina baik dalam bentuk modal maupun teknologi.

Cina adalah negara yang multi etnik yang memiliki 56 kelompok etnik dengan orang Han sebagai mayoritas (91.59 %). Sejak masa lampau, Cina dikenal sebagai bangsa yang memiliki peradaban yang maju, sehingga dapat

dikatakan sebagai pelopor pada beberapa bidang, seperti dalam pendidikan, sistem kesehatan dan meditasi, seni, teknologi keramik, astronomi, seni arsitektur, dan sebagainya. Cina juga dikenal sebagai negara perdagangan yang penduduknya memiliki semangat ekonomi, pantang menyerah, pekerja keras dan selalu menjaga kebudayaannya, walaupun mereka berpindah ke wilayah lain.

Pembaharuan Cina

Reformasi ekonomi merupakan salah satu langkah pembangunan yang bersejarah bagi Republik Rakyat Cina (RRC). Sebelum reformasi ekonomi, RRC diketahui sebagai negara komunis yang menggunakan strategi pembangunan terpimpin. Model pembangunan ini diperkenalkan oleh Mao Zedong yang dikenal dengan model pembangunan sosialis revolusioner. Salah satu karakteristik dari model pembangunan ini adalah memprioritaskan pada pembangunan sektor pertanian menduduki posisi teratas.¹⁶⁸ Menurut perspektif Mao, masyarakat sosialis yang modern dapat tercapai melalui proses transformasi yang muncul dari daerah pedesaan. Oleh sebab itu, pembangunan pertanian di daerah pedesaan menjadi tujuan utama pembangunan RRC pada periode 1949 hingga 1978.

Pada saat penerapan system tersebut, modal yang berasal dari sektor pertanian di daerah pedesaan ini tidak dapat diambil untuk mensuplai pembangunan industri di daerah perkotaan. Modal yang ada tersebut harus tetap berada di masyarakat pedesaan untuk memperbaiki kebutuhan nutrisi, kesehatan, pelayanan sosial, dan pendidikan para petani. Hal ini bertujuan untuk meningkatkan kekayaan masyarakat pedesaan, karena setiap penekanan pada sektor industri berat akan dianggap tidak menguntungkan bagi pembangunan sektor pertanian.

¹⁶⁸ Poltak Partogi Nainggolan, 1995, Reformasi Ekonomi RRC era Deng Xiaoping, hal 54

Strategi pembangunan yang dilakukan oleh Mao Zedong ada beberapa tahap. Tahap pertama merupakan tahap kondisi transisi menuju sistem sosialis (1953-1957). Periode ini ditekankan pada usaha untuk meningkatkan industrialisasi, kolektivisasi dalam bidang pertanian, dan setralisasi politik.

Setelah tahun 1955, pemerintah RRC merubah strategi pembangunannya dengan strategi lompatan jauh ke depan (1958-1960). Strategi ini diperkenalkan untuk mencapai pertumbuhan ekonomi tinggi dengan memberikan penekanan pada pembangunan sektor industri. Pelopor model pembangunan ini adalah Liu Sao Xi dan Deng Xiaoping. Pada model pembangunan ini, terdapat sistem perencanaan terpusat yang dikontrol oleh birokrat dalam hal koordinasi tugas dan tanggung jawab.

Kebijakan ini dilaksanakan dengan membentuk komune-komune rakyat di pedesaan. Komune ini dirancang untuk memungkinkan transisi dari sosialisme ke komunisme. Namun demikian, kebijakan ini memperlihatkan hasil yang bertolak belakang dari apa yang diharapkan Mao.¹⁶⁹ Hasil produksi pertanian dan sektor industri semakin memburuk. Komune rakyat tidak menunjukkan peningkatan produktivitas, sementara usaha swasta dan perseorangan dilarang oleh negara. Dalam keadaan seperti ini, produksi pertanian semakin menurun per satuan unit kerja. Empat tahun setelah gerakan lompatan jauh ke depan, timbulah masa kelaparan yang mengakibatkan 10 juta penduduk tewas (1962-1969).

Pada tahun 1961-1965 dilakukan tahap perbaikan dan pemulihan keadaan. Pada tahap ini dilakukan perbaikan pada arah politik sebagai sarana untuk menciptakan kekuatan kepemimpinan yang lebih moderat. Hal ini sebagai usaha untuk menstabilisasikan kondisi ekonomi.

Revolusi kebudayaan dilaksanakan pada tahun 1966 hingga 1976. Pada periode ini telah berdampak pada penurunan sektor produksi pada tahun 1967 dan baru pulih pada tahun 1969. Selama periode 1966-1976 ini terjadi

¹⁶⁹ Nainggolan Ibid. hal. 75

kekacauan dimana-mana. Sekolah-sekolah dan pabrik-pabrik ditutup, serta terjadi kemerosotan hidup masyarakat RRC. Dari segi pemerataan, strategi pembangunan Mao menghasilkan tingkat yang lebih tinggi dari negara berkembang manapun. Namun demikian, biaya sosial yang dikeluarkan terlalu besar dan banyak menelan korban manusia.

Tahun 1949–1978 dikenal dengan periode Sistem Ekonomi Komando - *Command Economic System*. Hampir selama 30 tahun ini, tujuan pembangunan ekonomi tidak tercapai dan standar hidup masyarakat Cina tidak banyak mengalami peningkatan. Penekanan yang besar banyak diberikan pada sektor pertanian dengan membagi-bagikan lahan-lahan pertanian kepada para petani. Namun kepemilikan ini tidaklah lama (1949-1952), karena sistem pemilikan bertentangan dengan sistem sosialis yang diterapkan Mao yang bersifat egaliter dan semua adalah milik bersama. Pada tahun 1950an terdapat kondisi: (1) terjadi kekurangan modal dan harga kebutuhan sangat tinggi, (2) jumlah tenaga kerja sangat berlimpah dan tingkat upah sangat rendah.

Setelah Mao dan Zhou Enlai meninggal pada tahun 1976, ahli waris mereka Deng Xiaoping dan Hua Guofeng melaksanakan modernisasi dengan menerima empat prinsip: RRC tetap negara sosialis; diktatur demokratik rakyat; keunggulan Partai Komunis Cina (PKC); dan Maoisme sebagai ideologi negara. Setelah itu, Deng Xiaoping mengkonsolidasikan pendukung-pendukungnya untuk melaksanakan serangkaian program reformasi ekonomi.

Untuk membangun perekonomian Cina maka dilakukan modernisasi pada empat bidang, yaitu pertanian, industri, ilmu pengetahuan dan teknologi, dan pertahanan. Reformasi ekonomi RRC dapat dilaksanakan karena dukungan dari berbagai faktor yang saling berkaitan satu sama lain, baik faktor internal maupun faktor eksternal. Faktor-faktor tersebut antara lain adalah sebagai berikut :

1. Perubahan struktur kepemimpinan di RRC pasca Mao Zedong berdampak pada menguatnya kelompok-kelompok reformis di bawah pimpinan Deng Xiaoping.

2. Strategi pembangunan Mao Zedong yang radikal dan mendahulukan pembangunan politik mengakibatkan banyak pengorbanan dan kemunduran.
3. Pilihan pada prioritas pembangunan ekonomi dalam rangka meningkatkan taraf kesejahteraan hidup rakyat.
4. Perkembangan politik global yang menunjukkan ancaman yang semakin berbahaya dari negara-negara adidaya dan musuh utama RRC.

Kebijakan reformasi ekonomi dimulai pada saat Deng Xioping berkuasa sejak Desember 1978 melalui sidang ketiga Konggres Nasional Partai Komunis Cina ke 11. Hal tersebut dilakukan dengan menafsirkan kembali ajaran komunisme untuk memberikan arah baru bagi kebijakan ekonomi dan pemerintahan RRC di masa mendatang. Esensi mendasar dari ajaran sosialisme menurutnya adalah berada dalam kebebasan dan perkembangan kekuatan produktif (Al Mandari, 2003). Selanjutnya dikatakan bahwa kriteria kegagalan atau keberhasilan sebuah partai haruslah dikembalikan kepada rakyat, apakah rakyat puas terhadap partai tersebut atau, apakah partai disukai rakyat atau tidak. Program-program ekonomi dianggap memiliki peranan untuk menentukan dukungan rakyat kepada PKC dan sekaligus RRC.

Rencana pembangunan dengan menggunakan ekonomi pasar dibagi dalam tiga tahap yaitu tahap permulaan (1978-1984), tahap eksplorasi (1984-1991), dan tahap standarisasi (1992-sekarang). Sebelum program reformasi ekonomi dijalankan, hampir seluruh perusahaan-perusahaan di RRC adalah milik seluruh masyarakat yang berbentuk perusahaan negara. Pada periode ini, terdapat sejumlah perusahaan yang dimiliki secara kolektif oleh masyarakat, namun manajemen pengelolaannya tidak berbeda dengan perusahaan negara. Hal tersebut dapat dipahami mengingat sistem perekonomian yang dijalankan sebelum reformasi adalah sistem ekonomi terencana (*a planned economy*).

Pada tahap permulaan ini (1978-1984), diletakkan pada perubahan struktur dan kondisi perusahaan-perusahaan milik negara. Pemerintah berusaha untuk meliberalisasikan perusahaan-perusahaan ini dan mengembangkan jenis

kepemilikan lainnya. Tujuan dari program ini adalah untuk menciptakan semangat kompetitif dalam sistem ekonomi, dalam hal ini adalah berusaha mencapai sistem pasar sosialis.

Pada tahun 1979 Cina memperkenalkan “*Coastal Development Strategy*” dan pembangunan zone ekonomi khusus - *Special Economic Zones (SEZs)* dibawah kebijakan ekonomi terbuka. Disamping itu, pada tahun 1980, Cina memulai strategi peningkatan produksi dan spesialisasi dalam bidang ekspor.

Selama periode ini juga merupakan periode pertama dilakukan pembangunan perusahaan-perusahaan di perkotaan. Hal ini didasarkan hasil kongres PKC ke-12 yang menetapkan reformasi pembangunan dari daerah pedesaan ke perkotaan dan reformasi perusahaan-perusahaan negara sebagai pusat dari program reformasi nasional.

Pada tahun 1984-1991 merupakan tahap eksplorasi. Pada oktober 1984 melalui Kongres Nasional kedua belas Partai Komunis Cina (PKC) pada pertemuan sesi ketiga, menghasilkan resolusi pembaharuan sistem ekonomi, dimana kolektivitas, individual, dan semua orang dapat berjalan bersama. Sektor-sektor ekonomi didorong untuk maju, baik milik bersama, kelompok/gabungan, individual, maupun yang dimiliki oleh dana asing. Mereka diharapkan dapat bekerja sama satu dengan lainnya dan dapat membangun perusahaan gabungan.¹⁷⁰

Selama tahun 1984-1991, rata-rata pertumbuhan jumlah output perusahaan negara per tahun mencapai 8,3%, sementara perusahaan-perusahaan non-negara mencapai 23,9% dan perusahaan publik mencapai 19,7%. Sedangkan rata-rata pertumbuhan output perusahaan individual di kota dan desa per tahun sebesar 45,4% dan pertumbuhan sektor industri sebesar 47,3%. Pada tahun 1991, output perusahaan non-negara tercatat memberikan kontribusi sebesar 43,8% terhadap total produksi. Hal ini dapat menggambarkan bahwa tingkat efisiensi perusahaan-perusahaan non-negara lebih tinggi dari

¹⁷⁰ Cit China. org. cn November 7, 2003

tahun 1980 pada akhir abad kedua puluh. Langkah ketiga, berusaha meningkatkan pendapatan perkapita pada tingkat diatas negara-negara berkembang lainnya dan tercapai pada pertengahan abad keduapuluh satu. Dalam hal ini, masyarakat Cina diharapkan telah mencapai modernisasi serta standar hidup yang tinggi dan lebih baik.

Reformasi ekonomi yang dilakukan RRC telah berdampak pada meningkatnya pertumbuhan ekonomi dan memperkuat posisi ekonomi RRC dalam tatanan ekonomi global. RRC telah tumbuh menjadi suatu negara dengan pertumbuhan ekonomi rata-rata 7-8% dalam 10 tahun terakhir. Kemajuan ekonomi yang cukup besar tersebut juga diiringi dengan kemampuan menarik investasi dan mendorong RRC menjadi salah satu pusat ekonomi dunia. Pada tahun 2000 ekonomi RRC telah tumbuh 8% dengan ekspor dan impor tumbuh masing-masing 27,9% dan 35,8% (Sutarjo,2003).

Selanjutnya pada tahun 2001 ketika banyak negara mengalami penurunan dalam pertumbuhan ekonomi, perekonomian RRC masih mampu tumbuh sebesar 7,3% dengan ekspor dan impor sebesar 6,8% dan 8,2%. Hal ini menyebabkan RRC menduduki posisi ke-9 dalam ekonomi dunia (Sutarjo,2003). Selama reformasi, Cina berhasil meningkatkan pembangunan ekonominya dengan rata-rata pertumbuhan GDP sebesar 9,4% dan dapat mengontrol tingkat inflasinya di bawah 10% dalam 10 tahun terakhir.

Keberhasilan program reformasi di RRC telah dipengaruhi beberapa faktor sebagai berikut (Sutarjo,2003). Pertama, reformasi dilakukan dengan hati-hati, bertahap, pragmatis, dan penuh kesabaran. Arah reformasi terlebih dahulu diletakkan untuk menjadi kerangka pelaksanaan kebijakan yang akan dibuat. Kedua, keberhasilan reformasi ekonomi juga diikuti oleh reformasi dalam bidang pemerintahan dan hukum. Pembangunan di bidang pemerintahan diarahkan pada penciptaan stabilitas nasional untuk mendukung pembangunan ekonomi. Pembangunan hukum ditunjukkan pada terciptanya *law enforcement* yang mampu memberikan rasa keadilan kepada rakyat.

Kemajuan dan kesejahteraan bisnis masyarakat Cina di Asia timur telah membawa negara ini siap terbuka bagi masyarakat internasional. Terutama bisnis-bisnis Cina yang telah menyebar ke wilayah lain seperti Hong Kong, Taiwan, dan negara Asia Tenggara lainnya. Hal ini menyebabkan, Cina harus siap menerima pertukaran ekonomi domestik dan internasional melalui mekanisme pasar dan menerima komponen-komponen strategi pembangunan nasionalnya sendiri dalam meningkatkan pertumbuhannya.

Perkembangan Ekonomi Cina

Meningkatnya pertumbuhan GDP Cina, perdagangan nasional, dan investasi asing, telah membawa Cina sebagai salah satu negara industri di Asia. Cina merupakan negara berkembang, namun usaha dan langkah-langkah yang diambil adalah menciptakan Cina menjadi salah satu negara maju di dunia. Penguatan pembangunan ekonomi melalui penekanan pada ilmu pengetahuan dan teknologi, menyebabkan Cina mampu menghadapi globalisasi dan persaingan ekonomi dunia melalui percepatan dan strukturalisasi ekonomi.

Peningkatan GDP Cina sangatlah menarik. Pada tahun 1990, GDP Cina mencapai 1854,79 trilyun yuan dan pada tahun 2000 menjadi 8946,81 trilyun yuan; dan ini meningkat sebesar 4,8% dalam 10 tahun. Cina juga terus berusaha meningkatkan tingkat kesejahteraannya dan membawa Cina ke tingkat modernisasi. Sehingga, pada tahun 2003 GDP Cina mencapai 11689,84 trilyun yuan dan berada pada tingkat ke delapan dunia.

**Gambar 3 GDP dan Rata-rata Pendapatan Perkapita
dari tahun 1978 hingga 2003**

Year	GDP (billion Yuan)	GDP Per Capita (Yuan/person)
1978	362.41	379
1985	896.44	853
1990	1854.79	1634
1995	5847.81	4854
1997	7446.26	6054
1998	7834.52	6308
2000	8946.81	7086
2003	11689.84	9073

Source: *China's Economic, 2004*¹⁷¹ and *People's Republic of China Yearbook 2004, Vol. 24*

Peningkatan pendapatan perkapita dan GDP dapat menggambarkan kemajuan industri dan pertanian Cina. Selama dua dekade, 1978-2000, Cina GDP telah meningkat rata-rata sebesar 9,3% setiap tahunnya. Cina GDP pada tahun 2000 hampir 10 kali GDP tahun 1985 sebesar 7.086 yuan per orang.

Ketika krisis ekonomi menghantam Asia, Cina masih dapat menikmati tingkat pertumbuhan ekonomi yang cukup tinggi. Negara-negara Asia sendiri masih terus berusaha memulihkan kondisi ekonominya, walaupun pertumbuhan ekonomi yang dihasilkan sangat lambat dan tidak sebaik sebelumnya, contohnya Indonesia.

Cina terus berusaha meningkatkan hasil-hasil produksi industri dan pertanian. Cina berusaha mencapai jumlah panen berasnya sebesar 500 juta ton pada tahun 2000. Namun hal ini dapat dicapai pada tahun 1998, dua tahun lebih cepat.

¹⁷¹ Wang Mengkui and Others, *China's Economic. China Basic Series, 2004. China Intercontinental Press, 2004, page 6*

Kondisi Ekspor - Impor Cina

Sejak kebijakan ekonomi terbuka, Cina terus mengalami peningkatan ekspor. Pada saat ini, Cina terkenal sebagai negara eksportir di Asia. Nilai ekspor Cina berjalan cepat dibandingkan nilai impor. Ini menandakan Cina telah berhasil meningkatkan pembangunannya, dan pertumbuhan ekspor merupakan mesin penggerak yang penting bagi pertumbuhan industri Cina. Antara tahun 1980 dan 2001, tingkat perdagangan ekspor Cina meningkat mencapai 29,4%. Kontribusi total ekspor dan impor Cina sebesar 59,2 % dan 41,5 % dari total nasional.¹⁷²

Pada tahun 1977 hingga 2001, perdagangan Cina tumbuh dari sebesar lima belas trilyun dollar menjadi 110 trilyun dollar. Kini Cina menduduki tingkat ke tujuh sebagai negara perdagangan terbesar di dunia. Tidak ada negara yang dapat meningkatkan peranannya dalam sistem perdagangan internasional secepat Cina dalam waktu 25 tahun. Bahkan Cina lebih cepat pertumbuhannya dibandingkan Jepang sebagai sebuah negara perdagangan. Ini berarti, Cina sangatlah cepat dalam pertumbuhan ekonomi domestiknya dan dalam ekspansinya ke pasar internasional.¹⁷³

Berdasarkan hasil penelitian Asian Development Bank, di Asia, Cina dimungkinkan akan memimpin negara-negara pengeksportir pada tahun 2010 dan sebagai pemimpin negara pengimpor pada tahun 2005. Sebagai negara berkembang, Cina telah berpengalaman dalam membangun kekuatan perekonomi negaranya, serta telah berhasil meningkatkan ilmu pengetahuan dan teknologi dalam bidang ekonomi untuk menghadapi modernisasi dan persaingan ekonomi global.¹⁷⁴

¹⁷² Ibid, page 76

¹⁷³ Nicholas R. Lardy, the Economic Future of China, Speeches in Asia Society, April 29, 2002

¹⁷⁴ Op. cit Wang Mengkui and others, page 16

investasi dalam ilmu pengetahuan dan teknologi. (5) sumber daya pertanian; dengan memberikan perlindungan bagi sumber daya pertanian seperti lahan-lahan yang dapat ditanami dan memberikan jaminan pertumbuhan ekonomi nasional yang stabil.¹⁷⁶

Pertumbuhan pertanian telah memberikan pengaruh pada segi lainnya, seperti kondisi perdagangan hasil-hasil pertanian, pertumbuhan sektor non pertanian, kesempatan tenaga kerja, pertumbuhan penduduk, masuknya investasi domestik, dan masuknya teknologi dalam lingkungan pertanian.

Industri Cina

Cina telah berhasil meningkatkan industrinya sejak tahun 1978 hingga 2003 yang mendukung peningkatan GDP Cina hingga 32 kali dan menghasilkan pertumbuhan rata-rata sebesar 15%. Cina juga telah berhasil mencapai sebagai negara industri, dimana sistem industri Cina telah lengkap dan hampir mencapai tingkat teknologi tinggi.¹⁷⁷ Melalui industrialisasi, struktur industri Cina telah meningkat dari tingkat yang rendah ke tingkat yang lebih tinggi.

Perubahan struktur industri Cina telah melalui evolusi dua faktor, yaitu, tingkat pendapatan perkapita dan penyediaan empat elemen faktor produksi (modal, tenaga kerja, mesin, dan sumber daya alam). Peningkatan pendapatan dapat merubah struktur permintaan ketika penawaran keempat elemen tersebut berubah dalam perdagangan dan pertukaran teknologi.¹⁷⁸

Sejak dimulainya reformasi ekonomi dan kebijakan ekonomi terbuka, Cina telah memasuki tahapan industrialisasi yang komprehensif dan signifikan

¹⁷⁶ Chi Fulin, *China's Economic Reform at the Turn of the Century*. China Institute for Reform and Development, Foreign Language Press Beijing, 2000, page 46

¹⁷⁷ Zheng Ping, *China's Geography: Natural conditions, Regional Economies, and Cultural Feature*. China Intercontinental Press, 1998, page 36

¹⁷⁸ Li Jingwen, *the Chinese Economy into the 21st Century*, Foreign Language Press Beijing, 2000, page 41

dalam perubahan struktur industri. Dari tahun 1978 hingga 1992, industri sekunder dan industri manufaktur primer mencapai pertumbuhan rata-rata 10,7%. Antara tahun 1978 dan 2002, pertanian sebagai industri primer meningkat 200%, ketika manufaktur sebagai industri sekunder meningkat 420% dan industri tertier meningkat 370%.

Perkembangan industri Cina selalu meningkat. Hal ini didukung oleh mekanisme insentif. Untuk meningkatkan mekanisme insentif pada perusahaan milik negara, pemerintah Cina memperbolehkan perusahaan milik negara untuk membagi hanya sedikit keuntungannya dengan negara; yang dimulai pada pertengahan tahun 1980an. Selain itu, perusahaan milik negara diperbolehkan untuk mencari keuntungan yang lebih besar bagi kepentingan perusahaannya.

Pertumbuhan perusahaan-perusahaan di perkotaan juga telah memberikan kontribusi bagi pertumbuhan industrialisasi. Disamping itu, perusahaan-perusahaan dengan investasi asing juga telah memberikan motivasi penting bagi perkembangan industri manufaktur Cina.

Banyak perusahaan multi nasional yang menempatkan pusat manufakturnya di Cina. Hal ini dikarenakan, mereka dapat memperoleh tenaga kerja Cina yang lebih baik dan murah serta Cina memiliki peluang membawa hasil industrinya ke pasar dunia. Disamping itu, Cina memiliki jumlah penduduk yang besar, yang menguntungkan bagi pasar domestik dibandingkan negara lain.

Jumlah penduduk yang besar menyebabkan Cina kaya pula akan sumber daya manusia. Oleh karena itu, Cina melalui program pendidikan nasionalnya berusaha meningkatkan jumlah ilmuwan, teknisi, dan pegawai manajerial yang akan memberikan peranan yang positif bagi perkembangan perekonomian Cina, seperti melakukan penelitian dan aplikasi teknologi dalam sektor pertanian dan industri, serta sebagai sumber ide bagi modernisasi Cina. Disamping itu, keberhasilan perekonomian Cina dibandingkan negara lain, karena Cina menekankan pengembangan komoditas pasar yang efektif dan menciptakan lingkungan pasar yang lebih baik dengan peningkatan produksi dan penawaran melalui mekanisme insentif dalam perusahaan.

Investasi di Cina

Usaha Cina lainnya dalam pembaharuan ekonomi adalah, Cina berusaha untuk memperbaiki hubungan ekonomi dengan negara lain, dengan berusaha memperoleh peralatan dan teknologi yang diperlukan bagi modernisasi Cina. Untuk mengundang modal asing, Cina berusaha menciptakan geografi negara yang nyaman dan bermanfaat bagi investasi asing. Kemudian menciptakan lingkungan investasi yang aman dan menguntungkan; infrastruktur yang baik; memberikan pajak khusus; sistem pelayanan yang baik; sarana dan prasarana yang lengkap; tenaga kerja yang berkualitas; peningkatan ilmu pengetahuan dan teknologi; dan administrasi yang efektif untuk menarik investasi dari perusahaan-perusahaan multi nasional yang berskala besar dan berteknologi tinggi dari berbagai belahan dunia. Ditambah lagi dengan usaha berbagai provinsi dan kota di Cina dalam menarik investasi dari perusahaan berskala kecil menengah dengan penyediaan lahan usaha dengan harga yang rendah dan tenaga kerja yang murah.

Sejak akhir tahun 1970an, Cina menerapkan kebijakan ekonomi terbuka dengan membuka wilayah sepanjang pantai untuk menarik investasi asing. Pembukaan daerah pantai ini merupakan usaha untuk membuka diri pada dunia luar. Cina memulai zona khusus dari Shenzhen dan daerah pantai lainnya (seperti Guangdong dan Fujian) untuk membangkitkan pembangunan industri berorientasi ekspor. Alasan lain Cina membuka daerah pantai, karena sebagian besar wilayah pantai ini memiliki basis industri yang lebih baik dan perekonomiannya lebih berkembang; lingkungan investasi yang nyaman; infrastruktur yang baik; dan konsep masyarakat dan kapasitas lokal yang memiliki daya tarik.

Investasi langsung sangat penting bagi Cina karena dapat membawa teknologi maju, sumber daya, modal, dan management perusahaan yang berpengalaman yang berguna bagi industri dan pembangunan perekonomian Cina. Untuk menarik investor asing, Cina berusaha meningkatkan transparansi kebijakan dan politiknya, memperkuat perlindungan hak kepemilikan intelektual, membangun sistem yang legal, dan lingkungan investasi yang terus ditingkatkan untuk menciptakan kepercayaan investor asing.

Cina berhasil menarik investasi asing langsung sebesar 500 triliun dolar AS saat ini. Ini berarti dari sejumlah investasi yang datang ke negara-negara berkembang, sepertiganya adalah masuk ke RRC. Perkembangan jumlah kontrak investasi yang masuk ke Cina semakin besar sejak tahun 2001 sebagai respon atas prospek Cina setelah menjadi anggota organisasi perdagangan dunia (WTO).

Investasi asing ini telah memberikan peranan yang aktif dalam mempromosikan perkembangan perekonomian di Cina. Investasi asing ini membuka hubungan internasional, khususnya dalam proses pembelian dan penjualan di pasar internasional. Investasi asing menjadi pilar percepatan pertumbuhan ekonomi dan membantu meningkatkan persaingan industri Cina serta mengoptimalkan struktur komoditi ekspor.

Cina dalam Ekonomi Global dan Perubahan Politik

Pada tahun 2003, dalam perekonomian dunia, Cina menduduki peringkat ketujuh dalam GDP dan menjadi kekuatan ekonomi terbesar kedua di dunia (berdasarkan indikator yang digunakan *purchasing power parity*).¹⁷⁹ Berdasarkan data International Monetary Fund (IMF), Cina dan ex-Cina (Hong-Kong and Macao) memberikan kontribusi 24,5% bagi total perdagangan pada tahun 2004. Pada tahun yang sama, total pertumbuhan perdagangan global meningkat 14%, sementara kontribusi Cina dan ex-Cina tumbuh sebesar 3,8% and 3,3%, di atas AS (2,2%) dan Jepang (1,0%). Ini berarti, Cina merupakan tantangan bagi AS dan Jepang dalam perdagangan internasional.

Kekuatan ekonomi Cina juga didukung oleh kekuatan ekonomi ex-Cina seperti Hong Kong and Macao. Negara ini, termasuk Taiwan menjadi pendukung perkembangan ekonomi Cina sejak periode reformasi 1978. Cina juga menunjukkan sebagai kekuatan ekonomi yang seimbang dengan AS,

¹⁷⁹ Maxine Koster and Kathleen Stephansen, 8 December 2004, China and the global economy, <http://research-and-analytics.csfb.com>.

Jepang, persekutuan negara Eropa, dan Rusia. Kontribusi Cina dalam perdagangan global dapat dilihat pada tabel di bawah ini.

Gambar 4 Kontribusi Cina dalam Perdagangan Global 1990-2004

Years	Global Total Trade Growth (%)	Contribution From (%)						
		China	Ex-China	USA	Asia	Japan	EU	Others
2004 trade share		7.0	17.5	15.4	24.6	6.5	18.1	35.4
1990	13.6	0.5	2.1	1.0	2.6	0.7	4.7	4.6
1995	18.9	1.2	4.0	2.1	5.2	1.5	3.1	7.0
2000	12.9	1.5	3.6	2.8	5.1	1.4	1.4	2.2
2001	-3.4	0.3	-1.5	-0.8	-1.2	-0.8	0.4	-1.0
2002	4.4	1.2	0.9	-0.1	2.1	0.0	0.7	1.6
2003	16.5	2.0	2.5	1.1	4.5	0.9	3.4	6.7
2004	14.0	3.8	3.3	2.2	7.1	1.0	3.3	0.4

Sources: Data Stream International Limited, IMF, in Global Economic Special, 8 December 2004.

Masuknya Cina menjadi anggota WTO merupakan pembaharuan ekonomi kedua yang penting bagi Cina, karena hal ini akan memberikan dampak yang mendalam bagi masa depan pembangunan ekonomi Cina. Disamping itu, keuntungan menjadi anggota perdagangan dunia, juga akan memberikan kesempatan bagi Cina untuk mempromosikan perdagangannya pada dunia internasional yang lebih luas.¹⁸⁰ Walaupun prinsip-prinsip pasar, implementasi hukum dan kebijakan yang ketat dalam sistem pasar, termasuk pada sektor perdagangan, dimungkinkan dapat merusak sektor-sektor yang ada (pertanian dan Industri khususnya).

¹⁸⁰ Warwick J. McKibbin, and KK Tang, Brookings discussion papers in international economics No. 137 The global economic impacts of trade and financial Reform in china, Revised Version: September 1998.

Keanggotaan Cina di WTO sejak 2001 akan memberikan dampak yang signifikan bagi ekonomi Cina, dimana pemerintah Cina akan melakukan proteksi pada sektor pertanian, pelayanan keuangan, dan telekomunikasi.¹⁸¹ Konsekuensi negatifnya, pada pertanian misalnya, akan terjadi pengurangan tenaga kerja yang akan menciptakan pengangguran yang besar di Cina. Konsekuensi negatif bagi perusahaan dan petani Cina ini, mungkin adalah masalah yang tidak akan diterima oleh administrasi Cina jika tidak ada tekanan dari pihak luar.¹⁸²

Pembaharuan ekonomi dan perubahan politik memiliki hubungan yang kuat. Perbedaan yang kontras antara Cina dengan negara Eropa lainnya dalam peranan negara dengan ekonomi adalah perbedaan yang jelas antara konsep negara bangsa, negara dan bangsa, dan bangsa atau negara.¹⁸³ Meskipun Cina adalah negara yang diatur oleh sistem Partai Komunis, namun karakteristiknya sistem ekonomi dan politik Cina pada saat ini menjadi berbeda, yaitu sosialis pasar.

Sejak reformasi ekonomi 1978, masyarakat Cina memiliki kebebasan dalam berekonomi. Kebebasan ekonomi ini untuk mencapai kekayaan melalui mekanisme pasar dimana masyarakat kini memiliki kekuatan politik pula dibandingkan sebelumnya. Perkembangan perdagangan dan investasi asing dengan sistem pintu terbukanya telah meningkatkan hubungan masyarakat Cina dengan pegawai pemerintahan serta dengan dunia luar. Kini, baik orang biasa maupun pegawai pemerintah memiliki keterbukaan dalam konsep hukum dan demokrasi.

¹⁸¹ Ray Bahl and Jorge Martino Vasquez, Fiscal Federalization and Economic Reform in China, International Studies Program Working Paper 03-13, May 2003, Andrew Young School of Policy Studies, Georgia State University.

¹⁸² Satya J. Gabriel, Lok. Cit.

¹⁸³ From fiefs to clans and network capitalism: explaining china's emerging economic order Administrative Science Quarterly, Dec, 1996 by Max Boisot, John Child

