

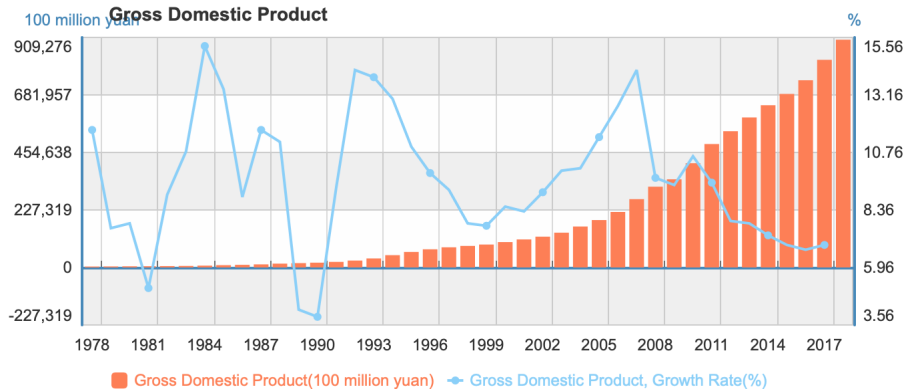
Deng Xiaoping's Economic Reforms

Econ 43750

N.C. Mark

University of Notre Dame and NBER

GDP level and growth



Overview

FT video on Deng

<https://www.youtube.com/watch?v=-us4TVAoy2U>

- Contrast in good (Deng) and bad (Mao) economic policy
- Kissinger calls him the 'indestructable Deng'.
 - Deng emerges as leader of the CCP
 - A pragmatic reformist
 - Definitely not a pro-democracy guy
- Policy goal: Make everybody rich.
 - Including the CCP. Everyone is in business. A mercantilist, pro-business government

Overview

- Deng declares **Socialism** with **Chinese characteristics**
 - **Socialism** is
 - Public ownership of capital
 - A centralized plan
 - Egalitarianism
 - Special attention to welfare of working people
 - **Chinese characteristics**
 - Reforms are **legitimate** as long as they **promote growth** and **do not** threaten the Chinese Communist party.
- Title of Huang's book: **Capitalism with Chinese Characteristics**

Overview

- Two phases
 - ① Rural. 1978-1992. Introduction of the market mechanism. Rural entrepreneurship. Note: Rural is **geographical**. Does not mean agriculture
 - ② Urban. 1993–ongoing. Urban and industrial. **SOE** reforms, internationalization, globalization.

In the 1980s, rural entrepreneurs moved to the cities and established operations there. In the 1990s, the rural laborers flooded the cities in search of jobs.

- China followed **gradualist** approach. Contrasts with Former Soviet Union

Overview of Huang

- 1980s, characterized by private entrepreneurship which develops in rural areas.
- 1990s, policy reversal. Government taxes rural areas and subsidizes development in urban areas, where firms are mainly SOEs.
 - ① This is urban bias, not dynamic or innovative. Is a hinderance.
 - ② Urban governments are corrupt
- Main argument: China's economic success is due mainly to (a) private-sector development, (b) financial liberalization (c) property rights security.

Structure of Government

- 1 State Council
- 2 Provincial
- 3 County
- 4 City/Village.
- 5 Danwei (workplace unit)

Types of Firms

- 1 State-owned enterprises (SOEs), state-owned banks (SOBs)
- 2 Collective enterprises
- 3 Private firms
- 4 Shareholding enterprises
- 5 Domestic joint-ownership firms
- 6 Foreign Invested Enterprises (FIEs)

The Challenge of Reform

- **The landscape:** Virtually no private businesses. Most significant urban enterprises were state owned, had little decision-making authority, and were more like government departments than business firms.
- Farmers were organized into rural collectives that owned all the land; they were forced to farm in teams and sell their output to the government at low, state-fixed prices.
- Individual prices and profit was meaningless. Companies had no stake in profitability.

Gradual reform

- China chose gradual reform. Not like big-bang reform of FSR. In FSR, if there were costs to overcome, due to distortions, elite privileges, rent-seeking, etc. then confront them right away. Let price system work, establish property rights reform (privatization).
- China: Felt huge risks, due to Cultural Revolution. If they failed, could be the end. Huge resources devoted to expensive industrial projects, nothing to satisfy consumers.
- Example: rural communities permitted to run township and village enterprises outside the plan because that would contribute to local investment and economic growth.
- Foreign businesses were allowed to operate freely in Special Economic Zones (SEZs) because that would increase investment in China and might persuade foreign corporations to transfer technology to China.

Dual Track System

- Dual Track System: coexistence of market and plan 1979, give up monopoly of SOEs for industrial production. Rural firms started up. Mix of private, collectively, foreign owned.
- SOEs and collectives: Assigned a compulsory output plan/procurement but they could use additional capacity to produce above the plan to sell in the market. Allowed SOEs to learn/adapt to the market.

Rural Sector Reforms—Agriculture

Production is collectively owned and managed. Collective enterprises: owned and managed by the village unit

- Collectives tried various things, then settled on a radical solution: **contracting** specific parcels of land to individual farm households.
- Becomes known (again) as the “**household responsibility system**” Collective leases rights to plots of land to households. Everything produced on the leased plot above the contractual amount to be forked over to the government, can be sold or eaten by the household.
 - Is a myth that this was initiated by Deng. He had the good sense to allow it.
 - Some rogue farmers banded together to do it. Deng simply allowed it to continue. (see the NYT op-ed “The Quiet Revolt That Saved China” by Michael Meyer)
 - Collective contracts with the farmer, to hand over (pay the tax) a quota.
 - Farmer gets to keep the **surplus**. Farmer can eat it or sell in a market
 - Farm households manage the agricultural production cycle on a specific plot of land. Agreement is to turn over contracted amount of low-price grain after the harvest.
 - Collectives become modern version of landlord. Chinese leaders did not block, and eventually gave it support. Agricultural output **surges**

Rural Sector Reforms-Collective Enterprises

- State gives up **monopoly** on **industrial production**. Encourages collectives to get into manufacturing
- The surge in agricultural productivity led to **surplus** of rural labor, that supplied the emerging **demand** for labor by TVEs.
 - Rural townships own largest number of collective enterprises, but are found in schools, neighborhoods and army units. These are **Township and Village Enterprises (TVEs)**.
 - Business can be farming, manufacturing, transportation, or commerce. Members decide how profits are distributed and retained, and how much people are paid.
 - This is a **locational designation**, not an ownership designation. Early on, most TVEs were collectives, but also private.
 - State sector is largely absent in rural areas

Rural Sector Reforms

- What is a TVE?

<https://www.youtube.com/watch?v=0pfK3Npc3mM>

- Some are poor. Others are very productive. Here's a really wealthy one, but you sell your soul to be part of it.

<https://www.youtube.com/watch?v=0ftrQQI1tOc>

<https://www.youtube.com/watch?v=vxc77UPPRaY&t=137s>

Township and Village Enterprises

- TVEs were the backbone of industrialization and growth. Not agriculture
- Origins of Chinese capitalism were **rural**. The central theme of Huang's book
- Many large private sector manufacturing enterprises were rural in nature.

Huang a Big Fan of Rural Entrepreneurship

- His data: Business income was fastest growing segment of rural household income. Also the share of business income rose.
- City people, highly educated people, not the entrepreneurial stars.
- Rural entrepreneurship was **not agricultural**.
- **Private sector** dynamism
- The star of Huang's show are **Township and Village Enterprises (TVE)**. What's a TVE?
 - Official definition and the official data include both TVEs controlled by townships and villages and TVEs controlled by private entrepreneurs. TVEs, as used by the Chinese, are a locational concept. Enterprises located in the townships and villages.
 - It's not what Stiglitz thinks, which is a public enterprise with a **distinct** ownership structure.
 - Huang claim: Most TVEs were never publically owned in the first place.

Township and Village Enterprises

- Many of the **largest manufacturing private-sector** firms hail from the **backward**, predominantly **agricultural** provinces of China.
- This is a striking empirical regularity.
 - Kelon Group, until 2005 China's largest refrigerator maker, was founded by entrepreneur in rural Shunde county in southern Guangdong province. item Huanyuan, China's largest air-conditioner maker, is based in the Hunan.
 - China's first automobile exports likely from the agricultural hinterland of Anhui province where Chery is located.
 - Very few successful corporate giants originated in Beijing and Shanghai and Tianjin.

Why Rural?

- Chinese peasants both entrepreneurial and motivated.
 - Central planning always weaker in rural areas than in the cities.
 - Mao recognized the huge entrepreneurial potential of rural people. Mao went to great lengths—through the commune system and Great Leap Forward, to destroy those potentials because he saw the threats to power of unleashing them.
 - One reason entrepreneurship initially developed in rural areas is education,
 - Cultural Revolution was mainly urban, which undermined the urban control of the countryside.
- Rural entrepreneurship was the way those people transitioned out of agriculture.
- Central planning was always weaker in rural areas than in cities

BCIA (Bureau of Industry and Commerce Administration) surveys the number of self-employment establishments registered.

Year	Urban	Rural
1981	0.86 million	0.96 million
1986	2.9 million	9.2 million
1988	3.8 million	10.7 million

The Washington Consensus

- Washington Consensus: Treasury, IMF, World Bank.
 - FDI. To get foreign capital, need
 - Well defined and enforceable property rights.
 - Well functioning legal system
 - Liberalized capital markets (no capital controls)
 - A convertible currency
 - Liberalized (free) trade

Huang's Take On China's Growth Miracle

- Huang claim: The China Puzzle: China's economic development doesn't fit within the standard economic framework in regard to economic liberalization, private sector development, political transition.
- Huang: There's no China puzzle. China's development was **classic and conventional**.
 - Private sector dynamism
 - Relatively supporting financial environment (through Hong Kong)
 - Increasing property rights security (really?)
 - Huang's account of Kelon contradicts his claim.
 - The founding entrepreneurs registered the firm as collective because there was no feasible alternative. The collective registration provided a mechanism for Rongqi township to expropriate the private assets of the company. Property rights security not institutionalized.
 - A factually correct interpretation of collective TVEs is that they enabled public stripping of private assets. Kelon was not alone.

Huang's Take

- Huang's view on **property rights** protection is he compares it in the 1980s to time during Cultural Revolution.
- Huang correctly notes the **household responsibility system (HRS)** was not launched by the Chinese leadership from the top down. Started by group of farmers in the poor village of Xiaogang in Anhui province.
- According to many accounts, farmers from 18 households in Xiaogang village secretly adopted the HRS on their own at a meeting in December 1978. They entered into a pledge, written in blood, that they would contribute toward the costs of raising the children of the leaders of the reforms if the ringleaders were to be arrested.

Achievements of 1980s were amazing

- They took place without large amounts of FDI, international trade, elimination of capital controls. (Washington consensus, what the IMF used to advocate).
- Occurred in absence of ideological commitment to economic liberalization. None of the Chinese policy makers had been exposed to free-market ideology, unlike reformers in Latin America or Indonesia (the so-called Chicago boys or Berkeley boys).
- Chinese reforms did not happen by a blueprint approach whereby the policy makers devised economic policy solutions on the basis of abstract ideas.
- We may agree with his view that the key ingredients of Chinese success in the 1980s were the context-specific innovations, a heavy reliance on local knowledge and a learning-by-doing experimentation