



Facing the Era of Great Transformation

Essays on deepening reforms

Wu Jinglian



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PREFACE

This book contains a selection of my articles from the period 2007–2013. The articles not only record my thinking on a number of important issues, but also reflect the course of China’s reform and development from both ideological and theoretical perspectives.

The first decade of the twenty-first century was a time of ideological upheaval, when China’s reforms entered a so-called “deep water area”. Some supporters of the old system and its ways had misled the public by using populist and nationalist slogans under the pretext of the spread of corruption and the polarization of rich and poor. They launched attacks on the Reform and Opening, and called for a return to the old system with “the planned economy as the central driver”—sometimes even calling for “the comprehensive dictatorship over the bourgeoisie”. Since 2007, in order to commemorate the 30th anniversary of the Reform and Opening, academia has made great strides in research on and assessment of that historical moment. Much evidence has been gathered together to prove that market-oriented reforms were the most important engine behind China’s rapidly-growing economy, and that to some extent responds to recent years’ attacks on the Reform and Opening itself. Nevertheless, controversy over the two distinct approaches and routes (deepening reforms versus going back to a centrally planned economy) has not ceased—and has become even more fierce since the global financial crisis broke out in 2008 and the economies of some developed countries suffered. I participated actively in this debate, and the articles in the

first part of this book reflect my thinking on the 30-year history of the Reform and Opening. At the same time, by referring to the experience of those historical ups and downs and the social transformations of the country, I analyze the challenges that China is facing at present and what strategies can be used to deal with them.

In my opinion, while great achievements have been made over the past 30 years of the Reform and Opening, further development of the economy and society is still facing challenges due to defects inherited from the old system. On the economic side, extensive economic growth driven by resource input and export demand have caused resource shortages and environmental damage to become increasingly prominent. Internal and external economic imbalances have intensified, financial markets are facing systemic risk, and macroeconomic policies are in the dilemma of being able to neither relax nor tighten. In terms of society and politics, the expanding base of rent-seekers, the spread of corruption, and the polarization of rich and poor were all caused by sluggish economic and political reform—and this has led to a strong public discontent that threatens social stability. Therefore, I call for removing obstacles, promoting reforms and building a market economy ruled by law (see “The Market Economy in China’s Reform” and “Economics and the Rise of China’s Economy”).

The second part of this book focuses on my views regarding the short-term and long-term problems facing China’s economy.

The 30th anniversary of the Reform and Opening should have been a good opportunity to take stock, to eliminate disadvantages and promote advantages, and to promote continuing reforms. However, the rapid economic growth of the past 30 years filled the country with optimism. Witnessing China’s achievements developing over the past 30 years, and then comparing them with the predicaments of developed countries after the outbreak of the global financial crisis, has made it difficult for people to accept any criticisms of China’s current system or development policies. I feel uneasy about this blind optimism, which ignores any shortcomings. In a speech in Shanghai in April 2008, I pointed out that under an extensive growth mode supported mainly by investment and exports, the severity of China’s asset bubble was no less than the level of Japan’s bubble economy on the eve of the Asian financial crisis. In addition, the CPI growth rate exceeded levels of moderate inflation. I also pointed out that in order to stabilize the economy and avoid major financial and economic crises, besides using short-term policies to stabilize the macro-economy, we must also take measures to remove any institutional obstacles to the

transformation of the present growth model in order to realize industrial upgrading (see “Inflation and Asset Bubbles Stem from Unsustainable Growth Patterns”).

Shortly after the Beijing Olympic Games ended, in August 2008, the liquidity shortage that began in 2007 quickly turned into a global financial crisis. China’s economic growth rate also declined, as export orders declined. In fact, the impact of the financial crisis was only an external factor, whereas China’s economic difficulties were largely caused by internal factors. One characteristic of China’s old growth model was that it relied on large amounts of investment to support high-speed economic growth. Faced with the problem of insufficient consumption demand as well as excess capacity caused by the growth mode, export-oriented policies were used to stimulate exports, and net export demand made up for the shortage of domestic demand. In their early stages of development, East Asian countries were often able to utilize “complementarity” relationships with developed countries, striking a balance between reserves and investments, successfully using export-oriented policies to support high-speed growth. But their experiences also show that, at a certain stage of development, such policies must be adjusted—otherwise they will cause disaster across East Asian countries, notably Japan (see the article “The Global Financial Crisis and the Chinese Economy”). In a word, this characteristic of the mode of economic development has made it difficult for China’s economy to sustain as early as was expected. The remedy can only be to promote reform, eliminate institutional obstacles to the transformation of the mode of economic development, and improve efficiency (see “The Man Who Does Not Think Far Ahead Will Have Trouble Near at Hand”). However, mainstream opinion misused Keynesian short-term analytic methods for estimating long-term trends, believing that as long as sufficient demand was created by fiscal and monetary policies, the Chinese economy would recover in an all-around way until Western countries got out of the crisis and increased imports. Under the influence of such opinion, the Chinese government issued forty trillion in investment and 100 trillion in loans at the end of 2008 to stimulate the economy, pledging to maintain an economic growth rate of more than 8%.

China’s rescue efforts have won considerable praise at home and abroad, but I am not optimistic. In my preface to the Chinese translation of Amity Shlae’s *The Forgotten Man: A New History of the Great Depression*, I wrote my worries about relying too heavily on Keynesian

stimulus policies: “The optimism generated after the emergence of the economic recovery is likely to prevent us from continuing to deepen our understanding of the mechanisms of the crisis. Without correctly dealing with various post-crisis policy issues, we will repeat the same mistakes” (see “Policy Reflections in a Period of Crisis”).

The transformation of the economic growth mode from extensive growth driven by investment and export to intensive growth supported by technological progress and improved efficiency has been a focus in my research for a long time. From 2007 to 2013, I repeatedly expressed my views on the theoretical and policy issues related to the transformation of the economic growth model. In my opinion, this is the real way that China can achieve sustained, stable and harmonious development.

During the Eleventh Five-Year Plan period (2006–2010), the plan to transform the economic development mode was not well-implemented, causing government at all levels to increase its efforts to promote the transformation of development along with structural optimization. However, the way that government behaves still has strong influence over China’s command economy, as many leading organs of the Party and government are accustomed to promoting technological innovation and structural adjustment in a government-led way. As a result, the exertion of ground-up creativity is inhibited, causing much effort to go to waste. In several articles, I focus on the government’s correct role in the transformation of economic development and innovative enterprise (see “Some Dos and Don’ts for the Government” and “The Government Should Not Play a Leading Role in ‘Adjusting Structure’”).

Promoting industrialization and modernization through urbanization is another major issue for China’s social and economic development. People from all walks of life have expressed different opinions on how to promote urbanization in China. There are also two talks in this collection which participate in that discussion. (see “Comprehensively Deepening Reform and the New Urbanization”)

The articles in the third part of this book show my unwavering answers to the important epochal question, “Where is China going?”—a question put forward once again at the beginning of the twenty-first century. Suffice to say, the reform agenda must be restarted as soon as possible.

Since the beginning of the century, due to the stagnation of reforms, various economic and social contradictions have accumulated rapidly under cover of economic prosperity. On the one hand, the shortage of resources, the increasing destruction of the environment, and even the

basic living conditions of human beings—including water, soil and air—have been damaged; on the other hand, corruption is spreading, the gap between rich and poor is wide, mass incidents are increasing, and violent tendencies have become more and more obvious, as have flashes of regional unrest. These facts show that China’s social and economic contradictions have reached a critical point. Apart from the competition between a market economy with rule of law and crony capitalism, China is also facing a race between reform and revolution. The question of “Where is China going?” is more acute than ever before, becoming an urgent proposition for the times (see “Where Will China Go in 2012?”).

Because people have interpreted the origins of these social and economic contradictions differently, the solutions and political appeals put forward are also very different. One is to strengthen the government’s and the state-owned economy’s control over society and the market. Some people advocate that it will only be through a “Chinese model” characterized by a strong government controlling the entire social and economic landscape that the “miracle of China” can be achieved—also serving as a model for the rest of the world to follow. The “theory” of the Chinese model has received more and more publicity.

On many occasions I’ve criticized this theory: if a “China-style” system is really established, it will pose a great threat to the improvement of the economic, social and political system, and sooner or later will lead to serious social and economic consequences (see “High Speed Rail: The ‘Miracle’ of the Chinese Model?”).

The “Chongqing Incident” of the early 2000s shows that in a situation where there is rampant corruption and a lack of justice, some figures may utilize social problems—using extreme “revolutionary” slogans (like “Beat local tyrants and divide the fields”) to mislead people who are deeply oppressed by the privileged class and eager to pursue what is fair and righteous, and leading them away from the actual course of things. The process of building a modern China is thus interrupted. Therefore, I call for the resumption of the reform agenda. “Only by adhering to the reform path of marketization, law and democratization, and by establishing an inclusive economic and political system, can China have a bright future” (see “Improving the Socialist Market Economy, Building Inclusive Political and Economic Systems”).

The fourth part of this book reflects my thinking on how to restart reforms, and my suggestions for reform.

The call, from all sectors of society, to restart the reform agenda, was echoed at the 18th National Congress of the Communist Party of China, held in November 2012. The 18th National Congress reiterated the goal of socialist market economy reform and put comprehensively deepening the reform on the agenda. But the problem we are facing is not whether to restart the Reform, but how to restart it. Therefore, many social organizations and people concerned about the future of the country have seriously explored the institutional reasons for our problems, and actively put forward reform proposals. Based on what we saw with previous reforms, I think that we should adopt a problem-oriented method and list reform projects, selecting the most important and most relevant ones—a “minimum package” reform program to inaugurate it in key areas (see “The Top Priority: Developing a Plan for Comprehensively Deepening Reform”).

I believe that the core of the new round of reform should be the establishment of a competitive market economy system. Market economies are massive, complex and complicated. The systematic reform of the market economy requires top-level design and comprehensive planning.

By taking into account all sectors of society, the Third Plenary Session of the Eighteenth Central Committee adopted the Decision of the Central Committee of the Communist Party of China on Several Major Issues Concerning the Comprehensive Deepening of Reform. With a historically new point of departure, it has made a strategic deployment for full reforms with the goal of perfecting the system of the market economy and promoting the modernization of governance. It is the overall design and plan of action for the next round of reforms in China, and will lead China’s Reform and Opening to a deeper level, establish a more mature system of the market economy and a modern system of national governance—having great historical significance for the realization of China’s takeoff and modernization (see “Fighting the Battle to Deepen Reform in a Comprehensive Way”).

China has now reached a new historical moment, and a new round of reform is gradually unfolding. At such a moment, we must clearly realize that reform is actually a revolution which gets rid of the old, and ushers the new in. It will inevitably encounter resistance from the old ideology, and face obstacles set up by vested interests who seek personal gain through power. It will also need to solve the difficulties accumulated throughout the old system and its extensive economic growth mode. And the difficulties and obstacles will need our joint efforts to overcome them. I sincerely hope that all of you will participate in the cause of

promoting reform, adding strength to China's modernization. It is the responsibility of every citizen to build a prosperous, democratic, civilized and harmonious modern China.

I hope that the discussions in this book will be of some reference value to observers of and participants in this great transformation.

Li Xin, the editor-in-chief of Sanlian Bookstore, first proposed this book. Mr. Ma Guochuan, the contributing editor, and Mr. Hao Jianliang, the project editor, undertook heavy editorial tasks. Ms. Zhang Xinwen accomplished sorting the work and inputting the manuscripts. Without their help, the book would not have been available in such a short time. Therefore, I sincerely thank them.

Beijing, China
New Year's Eve, January
2014

Wu Jinglian

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Let History Illuminate the Path to the Future



The Market Economy in China's Reform

(July 2008)

It has been 30 years since the beginning of China's Reform and Opening, in 1978, when the Third Plenary Session of the 11th Central Committee of the Communist Party of China met. According to the language of the 17th National Congress of the Communist Party of China, the goal of the Reform and Opening can be summarized as "a great historical turning point, away from a highly centralized planned economy to a vibrant socialist market economy, from a closed or semi-closed economy to one that is comprehensively open". At present, this historical turning point has not yet been fully realized. In order to achieve it satisfactorily, we should carefully consider 30 years' experience and lessons, and let history illuminate our future path.

This article is a speech given by the author on July 25, 2008, at the Seminar on the Commemoration of 30 Years of Reform and Opening", held at the Development and Research Center of the State Council of the People's Republic of China. The original title is "Let History Shine Over the Roots of the Future: On the Market Economy in China's Reform".

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“CROSSING THE RIVER BY FEELING FOR THE STONES”, AND SEEKING A PATH THROUGH DIFFICULTY

In 1953, China formally established the “general line for the transition period”¹ with the goal of “making socialist ownership of means of production the sole economic basis of our country and society”. After the “socialist transformation” of agriculture, handicrafts and capitalist industry and commerce, China established a Soviet-style centrally planned economic system.

The rigidly planned economic system dramatically reduced production efficiency and service quality. Owing to the fact that “production units” are subsidiary to state planning organs, enterprises lost autonomy, and their drive to produce, and leaders of the state-owned economy were particularly unimpressed by this new system introduced from the Soviet Union.

In the face of criticism of the Soviet-style planning system from both within and outside of the Party, Party and government leaders considered adjusting the system. As for the direction of the adjustment, there were different considerations. Chen Yun, the main leader of economic work, advocated that, under the premise of maintaining the dominant position of the state-owned economy as well as adhering to the planned economy, some factors of the market economy should be allowed in.² Mao Zedong, as the supreme leader of the Party and the state, believed that the problem lay not in the administration of a planned economy, but in the “excessive centralization of power” in the central government—too much management, and too rigid of control.³ In 1958 he started the movement of “transferring administrative functions to lower levels”, “relinquishing power and profits” to local governments, and forming a decentralized command economy.⁴ At the same time, Mao supported the

¹“Outline for the Study and Propaganda of the Party’s General Line in the Transition Period”, Publicity Department of the Communist Party of China, 1953.

²“New Problems After the Near-Completion of the Transition to Socialism”, Chen Yun, *Selected Works*, Vol. 3. Beijing: Peoples’ Press, 1953, 1986 edition, pp. 1–13.

³“On the Ten Major Relationships”, Mao Zedong, *Collected Works*, Vol. 5. Beijing: Peoples’ Press, 1956, 1977 edition, pp. 272–276.

⁴For issues related to this kind of economic system, refer to Wu Jinglian, *China’s Economic Reform*. Shanghai: Shanghai Far East Press, 1999, 2003 edition, pp. 49–54.

extreme “leftist” tendency⁵ towards “abolishing bourgeois legal power”. He launched the People’s Commune Movement, which reorganized agricultural production cooperatives into people’s communes which were a “political and social unity”; and he launched the Great Leap Forward to “overtake Britain and catch up with the United States”. These two campaigns seriously fanned the “Communist wind” and caused serious economic difficulties along with 20–40 million “abnormal deaths”.⁶

Mao Zedong did not think that the serious difficulties following 1958 were due to the mistakes of collectivization, the Great Leap Forward or the communist wind, but believed that the root cause was that the leaders of the Party and government, such as Liu Shaoqi and Deng Xiaoping, had deviated from the revolutionary line he advocated. Thus, he launched the Great Proletarian Cultural Revolution in 1966, based on the “theory of continuous revolution under the dictatorship of the proletariat”. This so-called “theory” at the level of government also had the character of being extremely “left”. Mao Zedong’s theory of “proletarian dictatorship” promoted at the climax of the Cultural Revolution unexpectedly declared that “distribution according to work and currency exchange are not much different from the old society”⁷ and that “capitalist groups within the Party” should be eliminated altogether. The “Cultural Revolution” put the whole of Chinese society on the verge of collapse. In the face of the political persecution of hundreds of millions of cadres and people in the Cultural Revolution, the government along with everyone else agreed that the old line and system could no longer continue, and consequently formed a consensus that reform must be carried out across society.

⁵Zhang Chunqiao published an article, “Abolishing Bourgeois Legal Power” in the magazine *Liberation*, Shanghai, September 16, 1958. Mao Zedong ordered *People’s Daily* to reprint it, October 13, 1958, and wrote a commendatory preface.

⁶Regarding estimations of unnatural deaths nationwide following the Great Leap Forward and the People’s Communes, please refer to “To Strengthen Statistics and Reform the Statistic System”, Sun Zhifang, *Economic Management*, issue 2, 1981; Cheng Min, *The Fate of Mt Lu*. Unity Press, 1993, p. 364; “Population Change Caused by the Great Leap Forward”, Li Chengrui, *Party History Studies*, issue 2, 1997; “The Great Famine: The Chinese Population from 1959–1961”, Cao Shuji, *Chinese Journal of Population Science*, issue 1, 2005.

⁷“Important Guidelines of Mao Zedong: October 1975–January 1976”, in *Manuscripts of Mao Zedong Since the Founding of the People’s Republic*, Vol. 13. Central Document Publishing House, 1998, p. 486.

The first action to initiate reform was launching the “ideological emancipation movement” at the Third Plenary Session of the Eleventh Central Committee to lift the shackles of extreme left ideology. Starting with a *Guangming Daily* article, “Practice is the Sole Criterion for Testing Truth” published in May, 1978, a nationwide movement for emancipating the mind was launched, laying the ideological foundation for the Reform and Opening.

On the basis of learning from the experiences of other countries and assessing oneself, people put forward various ideas for change. However, in the case of insufficient ideological and theoretical preparation for comprehensive reform at that time, Party and government leaders adopted the strategy of “crossing the river by feeling for the stones”, and made some flexible institutional arrangements while maintaining the dominant positions of state-owned enterprises and a centrally planned economy.

First, under the condition that land is still collectively owned, farmers’ family management would be restored in the form of “contracting production to households”. In the autumn of 1980, after the Central Committee of the Communist Party of China issued a letter acquiescing to the contracted production to households, a nationwide upsurge of contracted production to households emerged. By the beginning of 1983, 93% of the total production teams in China had implemented contracted production to households. The implementation greatly promoted the recovery and development of China’s agricultural sector. In 1985, the gross rural output value increased nearly three times⁸ compared with 1978. In 1984, the per capita net income of rural residents reached 355 yuan, an increase of 85.5%⁹ over 1980.

Second, on the premise of maintaining the unity of public finance and corporate finance, the implementation of the financial system of “separate meals” enabled local government at all levels to play a positive role in promoting local economic development. In order to alleviate the huge budget deficits from the late period of the Cultural Revolution and mobilize the enthusiasm of local governments to increase revenue and reduce

⁸National Bureau of Statistics, *Chinese Statistics Yearbook: 1989*. Beijing: China Statistics Press, 1989, p. 228.

⁹National Bureau of Statistics, calculations from the yearbooks of 1981 and 1985.

expenditure, the State Council decided to delegate part of the decision-making power of fiscal revenue and expenditure to local government at all levels from 1980 on. Apart from Beijing, Tianjin and Shanghai—municipalities directly under the Central Government—the other provinces and autonomous regions implemented a financial system of separate meals. The system allocated recipients between the central budget and the local budget in accordance with a predetermined proportion or absolute amount.

Third, alongside the “planning track” of material allocation and administrative pricing, the “market track” of material exchange and negotiated pricing was developed. In 1979, the State Council transmitted “Some Provisions on Expanding the Autonomy of Management of State-owned Enterprises” to allow enterprises to sell their own products beyond the plan in accordance with “bargaining”. In 1985, a “dual-track” system of supply and pricing of the means of production was introduced into state-owned enterprises. The establishment of a dual-track system enabled state-owned enterprises to purchase supplementary production materials and sell products through the market track, and also prepare the basic operating environment for the existence and development of non-state-owned enterprises.

Fourth, in the absence of the climate of a domestic market, we built a “microclimate” in “special economic zones” to dock with the international market. In the early stage of the Reform and Opening, it was completely impossible to form a unified domestic market and open it to the international market in a short period of time. Therefore, drawing on the experiences of other countries in establishing export processing zones and free ports, China made use of the advantages of the coastal areas adjacent to Hong Kong, Macao and Taiwan, as well as the large number of overseas Chinese, to create special economic zones as a base for opening to the outside world. In May 1980, it was decided to implement a special policy of opening up in Guangdong and Fujian provinces. In August 2000, it was approved to set up a pilot “regional export-oriented economic model dominated by market regulation” in Shenzhen, Zhuhai, Shantou and Xiamen.

It can be seen that the key to these flexible institutional arrangements was to introduce market economy factors as a supplement while keeping the basic framework of a centrally planned economy untouched. The emergence of market factors provided the possibility for some talented

people to actively engage in productive activities and promote the rapid recovery of the national economy.

The more far-reaching impact of these flexible institutional arrangements was the formation of a dual-track institutional environment. On the one hand, the state-owned economy (the stock part of the national economy), which is the basis of the planned economy, still operated according to the logic of the command economy; on the other hand, the newly developed private economy (the greater part of the national economy) still depended on or belonged to the local government to varying degrees—but its supply, production and marketing were generally market-oriented. On that basis, since the early 1980s, the private economy has expanded rapidly. The number of private enterprises in China has increased from 1.83 million in 1981 to 11.71 million in 1985, with an average annual growth rate of more than 159%.

GRADUALLY CLARIFYING THE GOALS OF MARKET ECONOMY REFORM

In the early 1980s, with the deepening of research into reform and the expansion of international communication, the theory of reform economics in China gradually surpassed the specific measures of “liberalization and decentralization” of the late 1970s. Some economists proposed other economic systems to replace the old planned economy system. By the mid-1980s, with the success of flexible policies, it was found that relying solely on unsystematic policies to “mobilize enthusiasm” could not achieve fundamental changes in the economy; on the contrary, it also brought about various conflicts and disorder. Therefore, it was necessary to explore what was the goal of the reform of the economic system.

During discussion, politicians, economists and academics put forward four models for institutional objectives.

1. The planned economy model of the post-Stalin period (“the improved Soviet model”). It advocated giving state-owned enterprises greater autonomy under the planned economic system. In the late 1970s, this method was first experimented with in Sichuan Province, called the “Expanding Enterprise Autonomy Pilot Project”, and then quickly spread across the country. However, such

reforms did not succeed, and soon ceased in the early 1980s because of huge fiscal deficit and economic disorder.

2. Market socialism (“the Eastern European model”).¹⁰ Hungary and other Eastern European countries, under the framework of maintaining the dominant position of a state-owned and planned economy, tried to introduce market elements into micro-level enterprises. In the early 1980s, some Chinese scholars wrote prolifically to introduce this model. However, with the economic reform of Hungary and other countries who were in trouble in the mid- and late-1980s, the influence of the model gradually waned.
3. The government-led market economy model (“the East Asian model”). After the end of World War II, Japan, South Korea, Singapore and other East Asian countries adopted a combination of authoritarian politics and the market economy to form a government-led market economy system with mercantilism¹¹ at its core. In the early stages of the Reform and Opening, this model had a great impact on China.
4. The free market economy model (“the European and American model”). Many theorists accepted the view established by classical economists such as Adam Smith, that the basic function of government was to provide public goods—including a stable macroeconomic environment. Governmental administrative intervention into microeconomic activities would hinder the effective operation of the market and breed corruption. In the East Asian model, the government had played a positive role in economic development, but it was only a phased alternative in the period when the market had not yet fully developed. Therefore, these economists were more inclined to take the mature market economies of Europe and America as the target model of reform.

¹⁰The basic feature of market socialism is, under the condition of maintaining the ruling position of nationalized ownership and national planning, to introduce some characteristics of market competition in order to improve the production efficiency of businesses. Please refer to “Market Socialism and China’s Economic Reform” (2005), Wu Jinglian, *A Call for a Market Economy Under the Rule of Law*. Beijing: Sanlian Books, 2007, pp. 419–435.

¹¹Mercantilism, a popular theory in Western Europe in the sixteenth and seventeenth centuries, advocated that the government engage in strong interference in economic activities in order to accumulate currency and to realize the goals of building the national army and a strong country. Adam Smith had an in-depth criticism of the theory and policies of mercantilism in his book *The Wealth of Nations*.

In the mid-1980s, while the influence of mode (1) and mode (2) gradually faded, mode (3) and mode (4) gained the upper hand. Generally speaking, in the latter two models, the East Asian model was often favored by officials, while the European and American model was the aspiration of scholars with modern economics knowledge. For example, Deng Xiaoping himself appreciated the “Four Little Dragons”—especially Singapore’s way of doing things. But popular books that introduce economics are always based on Classical Economics. Although the two models have fundamental differences between them as to the role of government, the differences between them did not occupy a prominent position as long as the centrally planned economy still occupied the dominant position. And even people who took the free market economy as the ultimate goal of reform often thought that in the sprint of rapid development away from a backwards economy, strong government often had more advantages than disadvantages. From the documents of the leading organs of the Party and government in China since 1984, people can see that when a theoretical exposition of reform objectives was made, it usually adopted the language of mode (4), but when specific measures were prescribed, the content of mode (3) was used.

In this way, with the joint efforts of reform-minded officials and scholars, at the Third Plenary Session of the 12th Central Committee of the Communist Party of China, in 1984, a reform acceptable to most people was formed: establishing a “socialist planned commodity economy” or “socialist commodity economy”.¹²

In October 1984, the Third Plenary Session of the 12th Central Committee of the Communist Party of China adopted the Decision of the Central Committee of the Communist Party of China on Economic System Reform (hereinafter referred to as the Decision). While determining that China’s reform should begin with a strategic shift from focusing on rural areas to focusing on urban areas, it also defined the goal of building a “socialist planned commodity economy”. The Decision pointed out that “the full development of a commodity economy

¹² “Commodity economy” is a Russian interpretation of the term “market economy”. In order to connect with “maintaining a planned economy as the main driver”, introduced at the 12th National Congress of the Communist Party of China, the Third Plenary Session of the 12th Central Committee of the Communist Party of China added “planned” in front of “commodity economy” in the Decision of the Central Committee of the Communist Party of China on Economic System Reform.

is an insurmountable stage of social and economic development and a necessary condition for realizing China's economic modernization. Only by fully developing the commodity economy can the economy be truly enlivened, and enterprises be encouraged to improve their efficiency, operate flexibly and adapt to complex and changeable social needs sensitively."

According to the Decision of the Third Plenary Session of the 12th Central Committee and the Proposal for the Seventh Five-Year Plan of the National Party Congress of the CPC, in 1985, the State Council put forward in March 1986 the idea of supporting reforms focusing on the price system, tax system and financial system, calling for decisive steps in 1987¹³ with a view to realizing the 1985 proposal by the late 1990s. In order to carry out this reform, the State Council in August 1986 formulated a supporting reform plan focusing on price, tax, finance and trade, which would be ready to implement in 1987.

However, in October 1986, the leadership of the State Council changed its original idea and turned to the reform of state-owned enterprises as the main line of reform. In 1987 and 1988, five systems, for "contracting out enterprises", "contracting out departments", "contracting out finances", "contracting out foreign trade" and "contracting out credit lines", were implemented. The practice of maintaining the coexistence of the market economy and the centrally planned economy would be returned to, and it was hoped that small fixes would improve the state-owned sector. Losing the momentum to push forward with reform, the result was the severe inflation of 1988.

After the economic crisis of 1988 and the political turmoil of 1989, some "theorists" and "politicians" who were dissatisfied with the reform blamed economic and political turmoil on the reform and accused "abolishing the planned economy and realizing marketization" as "changing the socialist system and implementing the capitalist system".¹⁴ Therefore, the second round of debates over reforms since the Reform and Opening began. It was not until early 1992 when Deng Xiaoping gave

¹³Zhao Ziyang's talk on the National Economic Work Session. See *People's Daily*, January 13, 1986.

¹⁴Wang Renzhi: "Speech Opposing the Liberalization of the Bourgeoisie at the Party Building Theory Research Workshop on December 15, 1989". *People's Daily*, February 22, 1990; *Qishi Magazine*, v.4, 1990.

his “Southern Tour”¹⁵ to promote the Reform and Opening that a new wave of the Reform and Opening was ushered in.

After the exploration of 1984–1987 and the twists and turns of 1989–1991, more and more people came to realize clearly that the new economic system to be established was the market economic system widely implemented in modern countries. The key to the problem was using the market to replace a plan for allocating economic resources, and determining what enterprises produce, how much they produce, who they produce for and how they distribute: in a word, microeconomic issues should be decided by the market, not a plan.

In October 1992, the 14th National Congress of the Communist Party of China clearly stipulated that the goal of the reform was to establish a socialist market economy.

FROM “INCREMENTAL REFORM” TO “OVERALL PROMOTION”

Although the market economy target model was gradually formed between 1984 and 1992, the actual progress of the reform is still being carried out through “incremental reforms”. That is to say, the original part of the planned economy (the base) should not be changed much, and reform and development should focus on additions. Because of its advantages in maintaining economic and social stability, promoting the development of the private economy and promoting the reform of the formerly state-owned sector through demonstrated effect and competitive pressure, the strategy of massive reforms played a very good role in the reform of the 1980s. However, because it did not touch the basic situation of the state-owned economy and the reform of the dual-track system, it also brought along with it a series of negative consequences. Among them, the most prominent are: (1) the financial situation of state-owned enterprises tends to deteriorate; (2) the recurrence of inflation caused by this; (3) the use of the dual-track system for the “rent-seeking

¹⁵ Deng Xiaoping. “Talking Points in Wuchang, Shenzhen, Zhuhai, Shanghai, etc.”, in the *Selected Works of Deng Xiaoping*, Vol. 3. Beijing: People’s Publishing House, 1992, 1993 edition, pp. 370–383.

activities” of power-seekers spreads day by day, and administrative corruption is spreading widely¹⁶; (4) the gap between the rich and the poor is widening day by day,¹⁷ and so on.

In order to overcome these shortcomings, the Chinese government proposed supporting reforms in 1986 in order to eliminate the state of “continuous confrontation of the dual-track system” and establish a market economy system in a comprehensive way. This reform has not yet been achieved. However, after the 14th National Congress of the Communist Party of China clearly declared the goal of market economy reform in 1992, the Third Plenary Session of the 14th Central Committee of the Communist Party of China in November 1993 made the Decision of the Central Committee of the Communist Party of China on Several Issues Concerning the Establishment of a Socialist Market Economy System. The Decision of the Third Plenary Session of the 14th Central Committee clearly put forward a new reform strategy of “overall promotion and key breakthroughs”, designed a series of important reform objectives and implementation steps, and called for the establishment of an initial market economy system by the end of the twentieth century. Since then, economic reform has entered a new stage with great strides.

First of all, as early as before the Third Plenary Session of the 14th Central Committee of the Communist Party of China, the reform to liberalize commodity prices stipulated in the supporting reform program of 1986 was realized under the condition of monetary tightening after 1988 and in the new wave of reforms resulting from Deng Xiaoping’s “Southern Tour”. Commodity prices were basically liberalized in the early 1990s, which meant that commodity markets were basically formed.

Second, in accordance with the requirements of the Decision of the Third Plenary Session of the 14th Central Committee of the Communist Party of China, fiscal and taxation system reform, monetary system reform and foreign exchange management system reform have been carried out since 1994.

The substance of the fiscal and taxation system reform includes the implementation of VAT, the unification of personal income tax and the

¹⁶See editorial section of *Comparative Economic and Social Systems*. “Corruption: Exchange of Currency and Power”. Beijing: China Outlook Press, 1st edition, 1989; *Corruption: Exchange of Power and Money*. China Economics Publishing House, 2nd edition, 1993.

¹⁷*Ibid.*, 2nd edition, 1993, pp. 69–70, 386–391.

strengthening of tax collection and management. In the late 1990s, the basic framework of a fiscal system and taxation system suitable for a market economy was established.

The reform of the monetary system focuses on the banking system. At that time, state-owned commercial banks, known as “professional banks”, had no distinction between government and enterprise, commercial and policy-oriented financial services, and lacked effective market constraints in credit activities outside the scope of government regulations; the central bank had unclear functions, outdated means of regulation and control, unreasonable organizational structure and fiscal systems, and could not effectively exercise the basic function of stabilizing currency. During the period 1993–1994, the following reforms were carried out in the banking system: the establishment of the central banking system, the change of monetary regulatory control from multi-level control to uni-level (central) control, and the establishment of an indirect regulatory control system; the transformation of the former four national-level professional banks into solely state-owned commercial banks; the establishment of several non-solely state-owned joint-stock banks; the decoupling of securities companies from the People’s Bank of China; dividing the People’s Insurance Company of China into three insurance companies: life insurance, property insurance and reinsurance; and so on. While reforming the banking system, China’s securities market also began to develop. After the resumption of the issuance of stocks and treasury bonds in the early 1980s, two stock exchanges, Shanghai and Shenzhen, were established in the late 1990 to conduct the majority of the trading of stocks.

The main content of the reform of the foreign exchange management system was to realize the convertibility of foreign exchange under current accounts, that is, to merge double exchange rates, to implement the managed floating exchange rate system, and to implement the system of bank settlement and sale of foreign exchange under current accounts. In the process of exchange rate mergers, the RMB depreciates deeply. This has played an important role in the rapid development of China’s foreign trade and the substantial improvement of its balance of payments since 1994.

Third, according to the Decision of the Third Plenary Session of the 14th CPC Central Committee on Several Major Issues Concerning the Reform and Development of State-owned Enterprises and the Company Law of the People’s Republic of China Promulgated by the Standing

Committee of the National People's Congress in December 1993, the pilot work of establishing a modern enterprise system in state-owned enterprises began in 1995. At the 15th National Congress of the CPC in 1997, especially at the 4th Plenary Session of the 15th CPC Central Committee in 1999, it was further clarified that all state-owned enterprises, except for a few enterprises that need to be operated by state monopoly, should carry out shareholding restructuring and establish an effective corporate governance structure on the basis of diversification of stock rights. Subsequently, most of the restructured listed enterprises (mostly secondary enterprises under solely state-owned group companies) built up the basic framework of corporate governance according to the Decision of the Fourth Plenary Session of the 15th Central Committee of the Communist Party of China on Several Major Issues Concerning the Reform and Development of State-owned Enterprises.

Finally, according to the requirements of the 15th National Congress of the CPC in 1997, the amendment to the Constitution of the People's Republic of China in 1998 clearly stipulates that keeping public ownership as the mainstay of the economy and allowing diverse forms of ownership to develop is the basic economic system of our country. From this, we began to adjust and improve the ownership structure of the national economy in accordance with the principle of "Three Benefits".¹⁸ This work includes three main contents: first, adjusting the layout of the state-owned economy to narrow the scope of the state-owned economy; second, trying to find various forms of public ownership that can promote the development of production; and third, encouraging the development of the private non-public economy, so as to make it an important part of the socialist market economy.

An important part of adjusting and improving the ownership structure is to "liberalize and invigorate small and medium-sized state-owned enterprises". At the turn of the century, most of the small and medium-sized state-owned enterprises and township enterprises affiliated to local government had been restructured by means of joint-stock corporation,

¹⁸ Deng Xiaoping put forward the famous "three favorables" criterion in his Southern Talks of early 1992, that is, "it is conducive to the development of socialist productive forces, is it conducive to enhancing the comprehensive strength of the socialist countries, and it is conducive to the improvement of living standards of the people." See Deng Xiaoping: "Talking Points in Wuchang, Shenzhen, Zhuhai, Shanghai, etc.", in *Selected Works of Deng Xiaoping*, Vol. III. Beijing: People's Publishing House, 1992, 1993 edition, p. 372.

overall sale, restructuring into limited liability companies or joint-stock limited companies. This has added a large number of new forces to the private economy.

After the above reforms, at the turn of the century, based on allowing diverse forms of ownership to develop, it has become the reform goal of establishing the market economy system. Its main manifestations are as follows: first, the increase of the share of the private economy and the formation of a pattern allowing diverse forms of ownership to develop. This pattern was first formed in the coastal areas, and then gradually extended to the interior. Where such ownership structures have been established, there are no exceptions to the rapid growth of social investment, the unprecedented activity of domestic and foreign trade, or overall economic prosperity. Second, the commodity market has been established and the factor market has begun to take shape, and it has played an increasingly important role in the effective allocation of resources. Third, the macroeconomic management system has been established. The foundation of this system began to be established in the fiscal and tax reforms reform, and monetary reforms, of 1994, which made it possible for the macroeconomic authorities to regulate the macroeconomy by means of aggregate measures such as fiscal and monetary policies, and played an important role in the macroeconomic regulation and control of the disinflation of 1994–1995, and the anti-recession of 1998–1999.

THE CHALLENGES OF PERFECTING THE MARKET ECONOMY

China's market system has been established over the past 30 years of the Reform and Opening. Its economic and social development have made great achievements that are universally acknowledged, and which are primarily manifested in several ways.

One: the rapid growth of total economic output. Driven by 30 years of the Reform and Opening, China's total economic output has grown at an average rate of 10% a year. Especially for a country with a large population, China has been weak for a very long time. Over the past 30 years, its GDP increased 17 times and its total economic output jumped to the global fourth place. Total imports and exports grew faster, jumping from 32nd place in the world to 3rd place in just 30 years. In short, after 30 years of the Reform and Opening, China has been recognized as

an important force for maintaining the stable development of the world economy.

Two, people's living standards have generally improved. During the 20 years prior to the Reform and Opening, from 1957 to 1977, the living standard of the residents of China, the basic consumption of grain, cloth, housing and cooking oil, and so on, did not improve. Over the past 30 years, the per capita disposable income of urban residents has increased from 343 yuan in 1978 to 13,786 yuan in 2007, and the per capita net income of rural residents has increased from 134 yuan in 1978 to 4140 yuan in 2007.

Three, great achievements have been made in poverty reduction. Over the past 30 years, the destitute in rural areas, whose basic livelihoods could not be guaranteed, have been reduced by more than 200 million people. Poverty reduction statistics published by the World Bank show that 90% of the world's poverty reduction from 1990 to 2002 was achieved in China.

However, while acknowledging the great achievements of the Reform and Opening over the past 30 years, due to shortcomings in the existing system, further developing the economy and society face challenges—some of them quite severe.

Although China's incremental strategy for reform was adopted from the beginning to better maintain the steady growth of the economy, it did not clearly explain the function of the government and the status of the state-owned economy—which was ambiguous in relation to the objectives of the reform model of the 1980s. This ambiguity enabled people with different tendencies to interpret reform objectives differently. After establishing the reform goal of the socialist market economy, different understandings emerged about what a "socialist" market economy meant. A considerable number of people, especially government officials, regarded the so-called "government-led market economy" of East Asian countries as the norm for the socialist market economy, and therefore often consciously or unconsciously reinforced the mercantilist tendency of strong government intervention in the system.

Therefore, after the initial establishment of the market economy, there has always been a problem of choosing "where to go" in our society: either establishing the rule of law, restricting administrative power, moving towards a market economy with rule of law, or following the mercantilist road and going astray. Under such circumstances, the people who insisted on establishing the market economy demand unswervingly