Theme II 2b: Transformation of East Asian Economies (China, 1978-2000)

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It doesn't matter whether the cat is black or white, as long as it catches mice

Deng Xiao Ping during a speech at the 1962 Communist Youth League

[1] https://www.chinadaily.com.cn/china/2014-08/21/content_18462132_15.htm

Remarks

1. The gapping problem in this set of notes is the length of LOAs, examples and its analysis. None of them should be this long
2. Some of the analysis might be a bit similar.
3. Some of the LOAs might be similar to each other (esp for Open-Door Policy)

Criteria for Significance

1. Transition from **central planning command economy** to a socialist market economy.
2. Integration into the global economy (Since for China, its economy was closed under Mao's leadership)
3. Economic growth (Characterised by high growth rates and other economic indicators)

Problems of Maoist Economy[2]

1. Due to the inherent flaws of Mao's central economy, their economic activities were planned by planners who possessed inadequate and inaccurate information. Consequently, with most of the plans and activities ill-informed and unsound, they hindered productivity and industrial efficiency. Hence China's industries were undermined and China's economic growth handicapped. These issues served as impetus for Deng to introduce sweeping changes.
    a. Failure to formulate sound policies were evident as there were frequent shifts in production. By 1956, 90% of the rural population were in 485,000 collective farms. This was reduced to 26,000 communes in 1958 but then expanded into 74,000 communes in 19644. **These constant shifts fostered a state of uncertainty among local administrators as well as among workers and peasants, disrupting production. This loses potential revenue and diminishes the agriculture sector's ability to achieve economic growth.**
    b. SOE's primarily used to fulfil the government's production and distribution objectives. **As a result, there were no monetary incentives owing to the lack of competition and any profits were to be handed to the government. Combined with poor management led by unqualified party cadres, SOEs were prone to poor performance. As a result, being the economic units in industrial enterprises, their failures would significantly hinder the industrial sector to contribute to China's GDP and hence economic growth to only 20%**
2. Furthermore, Mao's economic policies were envisioned with ideological objectives and executed without any pragmatic consideration. Hence they often slanted towards achieving ideological goals instead of what is needed by China's economy to grow. Without any considerations for the economy in mind, these politics fail as they are incompatible with the

[2] Must be careful since this is technically out of the syllabus timeframe. But "Problems of Maoist Economy" is still listed on the syllabus document. Sorry I forgot how to solve this problem

requirements needed for the economy to function. They resulted in an economic catastrophe that served as an urgent impetus for Deng to rectify.

  a. Mao used the Great Proletarian Cultural Revolution to get rid of his political rivals and key personnel such as engineers and scientists who were instrumental in the running of industries. **By replacing them with party cadres chosen for their loyalty over their expertise, industries and enterprises were led by those without knowledge as to how to manage them. Consequently, this resulted in long-term economic damage to government administration and factory management. This led to a 14% decline in production and thus reducing revenue in 1967, decreasing China's economic growth**
  b. As a result of the Anti-Rightist Campaign and Cultural Revolution, rampant xenophobia curtailed imports of foreign technological equipment which was required for technological advancements while the purging of intellectuals and experts limited China's ability to develop new technology. **Without advancements in technology, industries were unable to benefit from increased productivity and output that these technologies bring. By 19786, China's technology lagged 30 years behind world standards, denying their industry's potential and thus undermining their ability to contribute to China's economy, hindering growth.**

State Intervention

1. Deng's governing style and political sagacity prioritised a collective leadership decision-making process that ensured the political stability that China needed to recover from Mao's devastating rule as well as long term stability that provided a favourable environment for China's agricultural and industrial economic reforms to thrive from the late 1970s.
   a. Attributing the failures of Mao's economic policies due to his revolutionist fervour and lack of opposition against Mao, Deng introduced a collective leadership decision-making process to avoid the mistake of over-accumulating power in a single person. **This way, by not making the leader of CCP, the sole authority over decisions, all decisions made were derived with a consensus achieved between dissenting ideology and policy ideas and all factions in the government would have their visions fulfilled without political instability derived from incompatible visions, giving businesses the confidence to operate in such an environment.**
   b. Deng, with other elders, designated like-minded political succession in advance. **This way, with no ambiguity in who should take over, Deng ensured that there would be no political instability caused by fighting between party**

members, fragmentising and paralysing the party from effectively governing China's economic and peaceful transitions of power would ensure long term political stability, enabling economic growth.

2. Recognising the need for China's backward industries to modernise after Mao's xenophobic economic policies, Zhou En Lai's "4 Modernisations" were employed for technological modernisation. This boosted China's technological prowess by opening up nascent industries that enable China to benefit from innovation commercialisation and focusing on developing talents which help facilitate China's industrial modernisation, resulting in economic growth.
    a. To facilitate research and development, the CCP invested heavily in research centres It started the 863 program to promote (R&D) in strategic fields such as semiconductors with dual-use programs for civilian and military use as well as funded high-tech zones, first in Shenzhen, to further innovation commercialisation. **The development of the nascent tech sector has catalysed the increase in productivity in other fields, such as machinery in the steel industry.**
    b. China introduced crash training programs for over 800,000 researchers in areas such as computers while encouraging students and researchers to travel overseas to gain technical scientific education. This raises the number of students travelling to the US by 3.7%. **By amassing expertise, China is able to boost the development of its tech industries and support its research programmes to modernise its industries.**
3. Furthermore, Deng has ensured the continuity of his marketisation policies even after his political tenure has come to a close. By constantly affirming China's commitment to economic liberalisation, Deng gave businesses and the increasing number of foreign investors the confidence of the stability and profitability of China, enabling China to become an attractive consumer of investment after reforms seem to have slowed after Tiananmen, enabling China's continued economic growth.
    a. In 1992 during the 14th Party Congress, the CCP endorsed a "socialist market economy" as the goal of economic reforms. **This meant that the party was omitted to implementing market policies to achieve socialism ends and break down stifling state planning.** It was also reaffirmed when the CCP formally included "Building Socialism with Chinese Characteristics" in its guiding ideology in 1999. **This gave investors the confidence that as China formally accepts market mechanisms in China, they can now invest without fear of their businesses being interfered with by the government.** TVE output bloomed from 500 billion RMB to 2 trillion in 1995.

    b. Due to political uncertainty brought by Tiananmen and severe growth recession of 3.9% in the 1990, party hardliners wanted more planning and government control. Even worse, reformist Jiang Zemin had little political power since he was previously expelled and people were losing faith in China's marketisation. Deng had to instill confidence towards reforms by confirming China's commitment to economic liberalisation and the implementation of a radical free market. Deng's attempts via the Southern Tour through SEZ dispelled investors doubts on China's reform path that the Tiananmen incident resisted reforms solely in the political theatre while there was no red light to China's economic reforms. This dispelled investor's doubts on China's reform path, boosting FDI inflows by almost thrice.

4. Furthermore, as the state slowly introduced market forces, common issues associated in Laissez-faire economics emerged that threatened China's economic growth and sustainability and the state was able to successfully deal with them by implementing curative and preventive reforms. This ensured China's continued economic growth even in times of crisis.
    a. As banks were guided by the CCP, they lacked dispensed credit due to state planning rather than commercial considerations and without any mechanisms to track debt repayment. Consequently, unregulated bank lending had contributed to the boom and bust in the real estate and stock markets in the 1990s and had amassed more than 30% in NPLs. The government sought to resolve this by introducing Asset Management Companies to absorb $168 billion in NPLs and a law that made state banks responsible for managing their own operations and risks. **Other than rectifying the problem on the surface, the government was able to win back investor's confidence by introducing deep reaching regulations against reckless loaning, guaranteeing economic stability.**
    b. Increasing inflation caused by economic overheating and the decision to devalue the RMB to maintain the export-led boom, consumer prices quadrupled from 1992-1994. Zhu Rongji's austerity programme, the 16-point plan implemented monetary controls, allowing economic growth to remain relatively higher at 10%. **The state's ability to implement curative measures to cool off the economy by restricting the monetary supply and diverting investments to promote long-term infrastructure development shows its unparalleled role in resolving issues even in a more liberalised economy.**

5. However, the state's role in China's economic transformation was undermined by its initial indecisiveness in implementing reform policies which delayed economic liberalisation and subsequent failure in addressing problems caused by government policy.
    a. Initially, reform ideas were sketchy and disjointed as China did not have the knowhow to reform and lacked any economic vision to be their end goal. They

    were also contested by Chen Yun and other conservatives who were concerned at a loss of state control over the economy. Consequently, plans to spread profit retention schemes in SOEs were cancelled, leaving China's industries to fall under a centrally planned economy without any profit incentives.

   b. Due to rising monetary supply, inflation rose by more than 15% and prices rose an average of 74%, causing massive panic and a run on bank deposits. Facing this, the government was forced to reimpose price control for production materials and establish its monopoly over inputs to control speculation and disinflate. Even though the government was able to mitigate inflation, the flow in its policies was such that it led to a severe growth recession from 11.5^ to just 3.9% in the 1990s. **This highlights the devastating efforts of how when flaws in government policies are resolved with flawed solutions on China's economic growth.**

Market-Oriented Reforms

1. Market-Oriented Reforms liberalised China's economy as it set precedents for market forces to be introduced into China's economy at a large scale, transitioning China's centrally planned economy into a socialist market one by allowing privatisation and allowing the prices of consumer goods to float, reducing government intervention in the economy.
   a. In the urban industrial sector, 400,000 state enterprises were given a large measure of autonomy over wages and product prices while price reforms allowed for consumer goods to be priced according to the dictates of the market. **By introducing market forces, producers are incentivised to operate with profit considerations and produce based on demand instead of relying on the government to give out quotas, doing away with the old central planned economy in the urban industrial sector.**
   b. 1988 Provisional Act of Private Enterprises of the PRC and 1994 Company Law granted private enterprises the legal right to operate. In 2000, SOEs accounted for around 20% of China's GDP with enterprises accounting for the rest. With the government formally sanctioning private enterprise into the majority of the market, the boom in the contributions by enterprises made China's economy be dominantly led by market forces instead of the central government's plans and quotas.
2. Market-Oriented Reforms also granted farmers much more autonomy on agricultural output and opened opportunities for private enterprises to develop. As there now allowed for retail opportunities, people were much more incentivised to produce while favourable policies to promote enterprises made it easier for them to develop, increasing production output and sales revenue, enabling China;s economy to grow.

a. Under the”Household Responsibility System”, farmers were given control over the means of production and allowed to retain the surplus produce after hitting state quotas. **By enabl;ing households to make autonomous operational decisions and rewarding their efforts by allowing them to sell their produce, it significantly increased the incentive for households to work, save and invest in new means of production, resulting in greater productivity. This was evident from how the gross value of agricultural output grew at an average annual rate of 9%.**

b. From 1992-1994, the state accelerated the need to accelerate the development of TVEs to develop the economies of central and western regions. They provided industrial policies, tax support credits and personnel training. **Such favourable policies made the environment ripe for TVEs to grow due to much support from the state, reducing the challenges faced by TV**Es. As a result, the number of TVEs grew by 3 million while their share of GDP grew by 8%.

Open Door Policy

1. China’s open door policy integrated China into the global economy by implementing policies that lifted barriers for foreign enterprises to conduct business in China. By making it easier for foreign enterprises to have economic activity in China, China becomes more involved in global economic exchanges, thus integrating it into the global economy.
    a. 1986 Law on Enterprises Operated Exclusively with Foreign Capital formally permitted the establishment of wholly foreign-owned enterprises outside the SEZs. **By officially protecting foreign enterprises' right to conduct business in China under law, foreign enterprises had the confidence that no one could hinder their business operations by discriminating against their foreign status. This encouraged foreign businesses to set up in China by 10 fold in the 1990s, including MNCs like Coca Cola to integrate China into its business ventures around the world.**
    b. As per its preparations to join the WTO, it reduced the number of non-tariff barriers and barriers by 6 times to around 200 from 1992-1999. **By making trade with China more accessible and profitable companies were incentives to include China as an import and export destination, thus including China into various positions in the global supply chain, integrating China into the global economy**
2. China’s open door policy saw China set up its Special Economic Zones 9SEZ0 that offered preferential policies that attracted investors to pour in investments to set up business due to increased revenue while FTAs incentivised foreign enterprises to set up export-oriented

production lines, boosting China's exports and overall resulting in economic growth. (This is too much information to be in a TS)

   a. SEZs offer autonomous operating rights and tax incentives while excluding locally produced from duties. **This way, investors find it much easier to operate in SEZs without government intervention while the tax incentives attract them to do business as it is much more profitable. This resulted in an inspiring FDI totalling up to $1.17 billion, increasing capital formation that contributes 0.4% to GDP growth.**
   b. Pudong and Shenzhen both set up free trade areas in which exports and imports can be traded freely and enterprises were free to engage in export-oriented production. **As such, while leveraging on China's relatively cheap labour costs, investors can engage in more liberal trade and are incentivised to do so due to higher profit margins in the absence of trade-related taxes or tariffs. This boosted China's exports from $10 billion to $226 billion.**[3]

International Development

1. China has leveraged on its comparative advantage and evolving relations with countries to further integrate itself into the world's economy by serving as a cog in global supply chains and playing as an export destination and import source to large economies, thus conducting economic exchanges with the world.
   a. As Japan, South Korea and Taiwan phased out the textile industry, China used its abundance in resources and cheap labour costs to become a major supplier of raw materials like cotton to feed the textile industries of Japan and the Asian Tigers (42% of exports). **Thus leveraging on its comparative advantage to capitalise on industry transition in other countries, China became involved as a raw goods supplier to the textile supply chain.**
   b. As the USA seeks rapprochement with China, the normalisation of political relations and China's economic reforms paved the way for increased trade from 1 billion in 1978 to over 7 billion in 1985. (Evidence of impact should be about the development of Chinese economy) **Hence, China's warming up with the world facilitated China's role as a destination for exports and source of imports for major economies like the US, increasing its involvement in global trade.**
2. Furthermore, to leverage China's developing infrastructure and industry, countries pour in investments and engage in joint ventures with new Chinese companies. As a result, China is able to grow its industries into strong pillars for the economy by contributing to China's export volumes, resulting in economic growth.

[3] Although the analysis for both examples is fine, they are as bit similar. For the second example, consider how SEZs lead to FTA to show importance of expanding SEZs

a. In Shenzhen SEZ, Motorola's joint ventures to produce pagers introduced advanced semiconductor technology and production process, leveraging on the lack of local competition to profit from China's market for electronic market for electronic products in the meantime. **By liberalising China's economy, international companies conduct tech transfers that develop China's electronic industry, laying the foundation for Shenzhen to become a major electronic hub and a future pillar of China's economy.**

b. Hongkong investments were funnelled towards construction projects that facilitated China's trade like the Yantian Port Development Project in Shenzhen that accounts for 45% of GNP while overseas investments like Malaysia's Kerry Group were directed towards real estate and oil. **These investments help develop China's property and petroleum scenes into large industries in the future.**

3. However, international developments can at times threaten China's electronic growth as states seek to utilise trade relations to advance their political agendas, threatening to cut off trade while the volatility of the international economy can threaten FDI towards China in times of crisis as countries are unable to fund investments in China.

    a. Following Tiananmen in 1989, there was much pressure on the American government to impose tough action on China. In order to appease the people, the House unanimously approved a packet of touch sanctions. **Although this produced negligible effects, it proved that as China loses more control over its economic growth by opening up to its trade partners, trade becomes vulnerable to the willingness of countries to cooperate economically, losing its autonomy over its economic growth.**

    b. During the Asian Financial Crisis (AFC), Asia was reeling from crippling economic losses and were unable to fund investment projects overseas. Hongkong's FDI contributions to China fell from 55% to 41%. **Although western countries were able to increase their FDI, it proved that China's total FDI is in danger of unpredictable volatility as in the case of Hongkong, whose FDI fell over more than half.**