

The Engendering of a Market Economy in China

Gordon C. K. Cheung

This paper explores the facilitation of market forces in the transformation of Chinese society. Since 1978, economic openness has become China's macro-policy trajectory. In principle, market-oriented policy has been used as the linchpin of growth, as market behavior gives rise to opportunities for access, the enlargement of goals through production and consumption, and a manifest orientation that envisions change. Consequently, the statement "the state practices a socialist market economy" was added to China's constitution at the First Session of the Eighth National People's Congress on March 29, 1993.

This paper is divided into three sections. First, a brief illustration of market economy theories will be provided. Second, a framework will be put forward in order to understand the phenomenal changes of China's attitudes in four aspects as it moves toward a market economy. Third, some implications of China's movement toward a market economy will be discussed.

Keywords: transformation; economic development; consumption; information and communications

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Since 1978, economic openness has become China's macro-policy trajectory. In principle, market-oriented policy has been used as the linchpin of growth, as market behavior gives rise to opportunities for access, the enlargement of goals through production and consumption, and a manifest orientation that envisions change. The Chinese Communist Party (CCP) consequently added the market ingredient to China's constitution, which became an inalienable part of future Chinese policymaking. The constitutional amendments were made at the First Session of the Eighth National People's Congress (NPC)

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on March 29, 1993, the most important perhaps being the statement that "the state practices a socialist market economy," which was added to Article 7.¹ Subsequently, in October 1993, Chinese political theorists, including Ma Hong, published *What Is Socialist Market Economy*. The book served as a guiding principle and a formal testament to China's pursuit of a market economy.² Yet, the full implementation of market forces into China's economy has been affected by the preexisting state's influence in the economic and political spheres. Nevertheless, the major orientation of China's policies will still be linked with market forces in various capacities.

The essence of this paper will be demonstrating some ways in which market-oriented policies are facilitating a transformation in Chinese society. This paper will be divided into three sections. First, a brief illustration of market economy theories will be provided. Second, a framework will be put forward in order to understand the phenomenal changes of China's attitudes in four aspects as it moves toward a market economy. Third, some implications of China's movement toward a market economy will be discussed.

China's Development Trajectory and Policy Orientation

When Ezra F. Vogel's *One Step Ahead in China: Guangdong Under Reform* was published in 1989,³ many were still skeptical about the full implementation of economic reform in China. However, after a short break resulting from the 1989 Tiananmen crackdown, economic development based on market openness was as popular as ever. To a certain extent, many of the observations in this book are still true today, and are not only applicable to Guangdong but to China as a whole. For example, Vogel points out that "the movement to later stages of commodity society in the 1990s can be seen as a progressive breaking down of social and political barriers to the free flow of goods, labor, and capital,"⁴ which is a good description of contemporary phenomena in China. In essence, China's path toward a market economy and economic development can be illustrated in figure 1.

¹*Constitution of the People's Republic of China* (Beijing: Foreign Languages Press, 1994), 94.

²Ma Hong et al., eds., *What Is Socialist Market Economy* (Beijing: Chinese Development Press, 1993).

³Ezra F. Vogel, *One Step Ahead in China: Guangdong Under Reform* (Cambridge, Mass.: Harvard University Press, 1989).

⁴*Ibid.*, 397.

Figure 1
China's Path of Economic Development

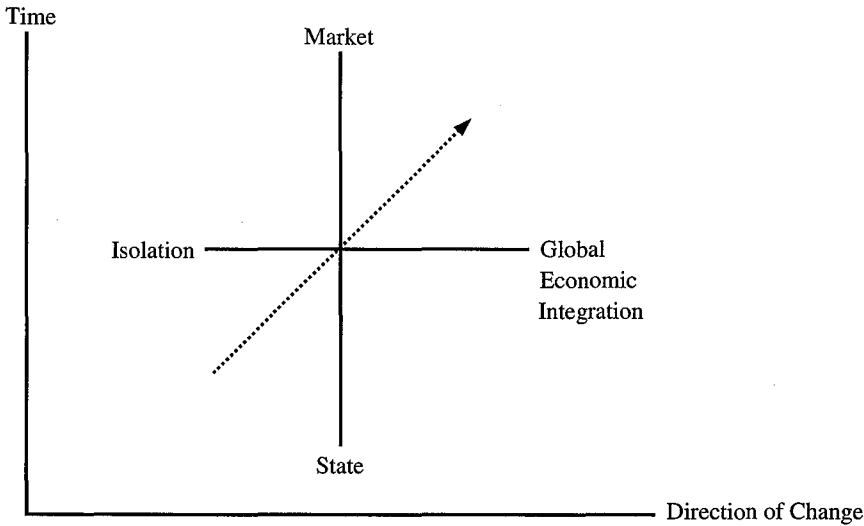


Figure 1 uses four concepts to accommodate China's development after 1978. The vertical axis indicates time, while the horizontal line represents the dimensions of change experienced by China during the opening of its economy. The dichotomies between state and market and between isolation and global economic integration generally capture the directions and logical changes behind China's development.

As figure 1 indicates, the movement toward global economic integration and market openness has become distinct over time. In addition, the dotted line shows that the magnitude of change can be lessened through macroeconomic adjustment or inflation. The logical progression of market forces in China's development is identifiable, but its magnitude should be studied in individual cases. Before we look at the ingredients of changes in the Chinese economy, however, we should first explore the theoretical relationship between market impetus and transformation effects.

Historically, the transformation effects of markets on society have long been an academic focal point. Karl Polanyi's groundbreaking book *The Great Transformation* studies the anatomy, the patterns of change, and the facilitation of market economy changes in the nineteenth century.⁵ According to Polanyi, the "self-regulating" nature of market behavior actually pushed the world

⁵Karl Polanyi, *The Great Transformation* (Boston: Beacon Press, 1944).

toward an "astonished new page."⁶ In addition, as argued by Edward J. Nell, market outcomes are not "optimal, but rather . . . have a certain objectivity and reflect robust good sense. If you pay attention to the market signals, you ought to do all right; if you don't, you will run a serious risk of going under."⁷ Market momentum and the dynamic forces of liberalism have energized growth of the global economy in an unprecedented manner, as recently attributed by empirical studies and research.⁸ The post-Cold War international economy has witnessed rapid changes in the economic structures of many former socialist countries, as the demise of the Soviet Union has encouraged the transformation of many centrally-planned economies to market-oriented economies. The introduction of private property rights and the vigorousness of market competition have also been noted by many international organizations.⁹

Fortunately, the market, as an agency of change, has performed well in regulating various transactions in China without violating its political ecology. As Susan L. Shirk puts it, "The lesson of the Chinese case is that in some varieties of communism, it is possible to move from a command economy to market competition without changing the political rules of the game. Communist rule in and of itself is not an insuperable obstacle to economic transformation."¹⁰ Adaptation to the disciplinary guidance of market forces has engendered a mode for changes of policy orientation toward internal development as well as foreign investment. In particular, the need for capital and technology for China's economic reform and development has inevitably led to deregulation policies and relaxation. This change is clearly depicted in Margaret M. Pearson's study on foreign direct investment (FDI) in China. She points out:

The growing belief that their [Chinese] economic modernization program required them to absorb foreign capital at even greater levels put them on a course whereby they had to pay attention to foreign concerns, and more generally to ways they might be able to improve the investment environment. Under these condition, the reformers had little choice but to liberalize.¹¹

⁶Ibid., 3.

⁷Edward J. Nell, *Making Sense of a Change Economy: Technology, Markets and Morals* (London: Routledge, 1996), 51.

⁸Alfred D. Chandler, Jr., *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge, Mass.: The Belknap Press of Harvard University Press, 1990).

⁹Hans Blommestein and Michael Marrese, *Transformation of Planned Economies: Property Rights Reform and Macroeconomic Stability* (Paris: OECD, 1991). This example is only one of many on the privatization of former socialist states.

¹⁰Susan L. Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993), 334.

¹¹Margaret M. Pearson, *Joint Ventures in the People's Republic of China* (Princeton, N.J.: Princeton University Press, 1991), 213.

Furthermore, the recent attitude of the international society toward China's economic reform has been positive. In a recent article in the *International Herald Tribune*, Pieter Bottelier, the World Bank's mission chief in Beijing, summarized China's economic reform by stating that "few elements of the old centrally planned and closed economy [have been] left untouched."¹²

To further understand the concrete factors which demonstrate to what extent and in what directions changes are being nurtured, we will in effect examine the upper right-hand quarter of figure 1 for the details.

Four Major Changes Toward a Market Economy in China

The following section will attempt to highlight some of the major loci for changes in China's economy toward market openness, namely the entrepreneurial system, the market system, the legal system, and economic planning. Pinpointing these four elements is by no means a haphazard choice, as their importance has been noted by the state as well as laymen. In terms of transformation, these variables have reshaped the direction and context of China's economic development. We will consider them one by one.

The Entrepreneurial System

Although state-owned enterprises (SOEs) symbolize China's communism and socialism, these industries have long been inefficient and ineffective. At the Fifth Session of the Eighth NPC and the Chinese People's Political Consultative Conference (CPPCC) in February 1997, delegates called for "a quick structural readjustment of China's manufacturing industry."¹³ CCP General Secretary Jiang Zemin also promised "to strengthen management of the market and establish a better market framework."¹⁴ For example, reform in Shanghai would leave 290,000 workers unemployed, according to Shanghai Mayor Xu Kuangdi, although it is necessary for Shanghai to upgrade its industries and become an international financial center.¹⁵ The move indicates that the Chinese economy will consider market competition as the most im-

¹²Pieter Bottelier, "China's Economic Reforms Are Gradual But They're Working," *International Herald Tribune*, July 3, 1997, 8.

¹³Ivan Tang, "Calls for Action on Industry 'Plague'," *South China Morning Post*, March 8, 1997, 6.

¹⁴Agatha Ngai and Daniel Kwan, "Jiang Vows to Step Up State Sector Reforms," *ibid.*, March 4, 1997, 10.

¹⁵Agatha Ngai, "Shanghai Loses 290,000 Jobs in Industrial Shift," *ibid.*, March, 6, 1997, 10.

portant factor. For example, Xiaowen Tian concludes in a study of the rise of non-state-owned enterprises in China that "in transition economies, governments should make full use of market mechanisms to encourage the development of non-state-owned enterprises so as to accelerate economic growth by increasing efficiency in resource allocation/utilization."¹⁶

In actuality, the reform of state industries has been part of the movement toward a market economy. One of the major methods of reforming SOEs has been mergers. According to official statistics, more than 2,900 enterprises in China have been merged, either by relying on investment from overseas companies or through their own efforts.¹⁷ As an example of the latter, the merger of seven unprofitable enterprises by a famous Shanghai underwear manufacturer named Three Gun was praised by the Chinese government, since the merger enabled the enterprises to become profitable.¹⁸

Moreover, some Chinese state industries have gone public in the Hong Kong stock exchange under the categories of Shanghai A and B and Shenzhen A and B. Chinese stocks have even outperformed other Asian stocks recently; for example, Shanghai A and B and Shenzhen A and B ranked as the highest four indices in the Pacific Rim, with returns ranging from 60.74 percent to 23.54 percent.¹⁹ This trend is very salient for Hong Kong's existing financial industry, but its magnitude needs further investigation.

The Market System

With new reforms after 1978, the Chinese economy was overhauled. Development based on production and consumption swiftly energized nearly every sector of China, with two major booms in consumption demand in 1985-86 and 1987-88.²⁰ With the rise in income levels, there was a steady drop in the purchase of foodstuffs and an increase in the consumption of durable goods and services such as washing machines, refrigerators, color television sets, and sewing machines.²¹ For example, changes in Guangzhou residents' behavior were clearly identified from the changes in their consumption patterns. According to *Guangzhou Yearbook 1996*, two dramatic changes in consump-

¹⁶Xiaowen Tian, "The Rise of Non-State-Owned Enterprises in China," *Communist Economics & Economic Transformation* 9, no. 2 (1997): 229.

¹⁷Li Rongxia, "Second High Tide of the Merger of Enterprises," *Beijing Review* 40, no. 38 (September 22-28, 1997): 12.

¹⁸*Ibid.*

¹⁹*South China Morning Post*, May 12, 1997, "Business," 1.

²⁰*Heng Seng Economic Monthly*, November 1992, 1.

²¹*Ibid.*, 3.

tion were indicated. First, the monthly demand for transportation and communications had risen sharply from 24.41 *yuan* in 1994 to 39.69 *yuan* in 1995 per person, for an increase of 62.60 percent.²² Second, the monthly demand for merchandises and services had also increased from 25.26 *yuan* in 1994 to 40.20 *yuan* in 1995 per person, or a rise of 59.14 percent.²³

Moreover, consumption changes have also witnessed the growing influence of products, i.e., telephone and paper, that improve the efficiency and effectiveness of communications and information flows, which in turn will nurture a market economy in China. Whether one believes that information is a tool of government or a tool against government,²⁴ the power of knowledge and information²⁵ will generate changes based not only on consumption patterns but also on individual behavior.

However, since the Chinese economy is still governed through macro adjustments by the state, price levels have not necessarily reflected genuine market prices. For instance, inflation rates and consumer price rates may not truly reflect consumption levels.²⁶ Only when deregulation and privatization of SOEs is fully implemented can genuine consumption levels be accurately measured.

The Legal System: Taxation Reform

Major taxation reform was introduced along with market socialism at the Third Plenum of the CCP's Fourteenth Central Committee from November 11-14, 1993. The focus of this meeting was the "Decision on Some Issues Concerning the Establishment of a Socialist Market Economy."²⁷ A com-

²²*Guangzhou nianjian 1996* (Guangzhou yearbook 1996) (Guangzhou: Guangzhou nianjian chubanshe, 1996), 383.

²³*Ibid.*

²⁴Joshua S. Goldstein, *International Relations* (New York: HarperCollins College Publishers, 1994), 411-16.

²⁵Peter F. Drucker, *Post-Capitalist Society* (New York: Harper Business, 1993), 183.

²⁶*Asian Monetary Monitor*, May-June 1995, 14.

²⁷*People's Daily*, November 15, 1993, 1; *China News Analysis* (Taipei), December 1, 1993, 4; and *Wen Wei Po* (Hong Kong), November 12, 1993. For a more detailed explanation of the new taxation system, refer to the following three volumes: *Zhongguo gaige quanshu, 1978-1991* (Handbook of Chinese reforms 1978-1991) (Dalian: Dalian chubanshe, 1992), particularly chapter 6 "Reform of the Taxation Structure"; Wang Chuanlun and Wang Pingwu, eds., *Zhongguo xin shuizhi yiwu quanshu* (Handbook of Chinese new taxation and duties) (Beijing: Zhongguo jinrong chubanshe, 1994); and Hao Zhaocheng et al., *Caishui: Tizhi tupo yu liyi chongzu* (Taxation: Structural breakthrough and interest reconstruction) (Beijing: Zhongguo caizheng jingji chubanshe, 1993). The first gives a general historical perspective on the post-1978 reforms and criticisms of them, while the second concentrates on the taxation reform in late 1993. The final book is one of a series concerning the structural change of Chinese economic development.

munique containing ten chapters was issued immediately after the meeting which can be categorized as three aspects: (1) development of a better market structure; (2) acceleration of macroeconomic control; and (3) SOE reforms.²⁸ Taxation reform was one of the major topics.

The concept behind taxation reform was summarized by Minister of Finance Liu Zhongli as follows:

The financial and taxation reform to be launched next year [January 1, 1994] [will be] an important component of the establishment of a socialist market economic structure and a major measure vital to the country's long-term stability and order, and future economic development, as well as reform of the economic structure as a whole.²⁹

The reform per se is meant to generate a substantial increase in central government revenue in the coming fiscal year. The new taxation system will also redefine the income distribution and power structure between the central and local governments. Finally, it will propel China's internationalization and its efforts to catch up with world standards, as the concept behind it is borrowed from many advanced countries.³⁰ From the government point of view, the new taxation system is not only set forth as the macroeconomic restructuring of central-local relations, but also enables the germination of a reasonable sharing of revenues based on the utilization of market forces.³¹

Conceptual Changes in Economic Planning

Planning is said to be a rational way of distributing a country's resources which in theory should be achievable and realistic. It has also been a guiding principle for Chinese economic development since the First Five-Year Plan (1953-57), which was supposed to adapt China's system to follow the Soviet Union's, but it was not wholeheartedly adopted by the Chinese. The Second Five-Year Plan (1958-62) and the Third Five-Year Plan (1966-70) were not implemented due to the chaos of the Great Leap Forward and the Cultural Revolution. Moreover, the objectives of the plans fell short because their socialist idealistic nature clashed with political power struggles occurring in China at the time.

After the Cold War, the Eighth Five-Year Plan (1991-95) targeted eco-

²⁸Wen Wei Po, November 17, 1993, 1-3.

²⁹Foreign Broadcast Information Service, *Daily Report: China*-93-235 (December 9, 1993): 24.

³⁰*China Economic News* 14, no. 48 (December 13, 1993): 1-2; and *Beijing Review* 37, no. 11 (March 14-20, 1994): 12-15.

³¹"Reform of the Taxation Structure," 434.

conomic development in terms of sectoral growth, income distribution, control of the budget, and other social aspects, all of which clearly pointed toward market openness.³² The major breakthrough has come with the Ninth Five-Year Plan (1996-2000), which outlines the structural transformation of a centrally-planned economy into a market-oriented one.³³ Under this plan, as summarized by the *Hang Seng Economic Monthly*, "the enactment of a comprehensive and enforceable set of commercial laws and the growing size of the non-state sector should help define a more conducive business environment. All these would add vigor to the Chinese economy and help to maintain its future growth momentum."³⁴

In theory, the change of central planning from an attitude against competition toward planning that enhances competition comes very close to Friedrich A. Hayek's argument that the gist of planning should "make competition as effective and beneficial as possible."³⁵ Since it is unrealistic to expect China will completely abandon planning and centralization, the movement toward a market economy, as realized in planning, is a necessary step toward an open economy.

Implications

As indicated by figure 2, the previously-discussed four elements fall in the spectrum of market forces and global economic integration depicted in figure 1. Each arc in figure 2 represents the possibility frontier of moving toward a market economy. The vertical axis measures the degree of marketization, while the horizontal axis measures the pace toward global economic integration.

In theory, the four-dimensional changes in China (the market system, the entrepreneurial system, economic planning, and taxation reform) will fall within different arcs in relation to different combinations of marketization magnitude and global economic integration. Although the placement of each element in figure 2 is rather arbitrary, their function in helping China move into a market economy is beyond doubt.

Nevertheless, it should be emphasized that the placement of these four

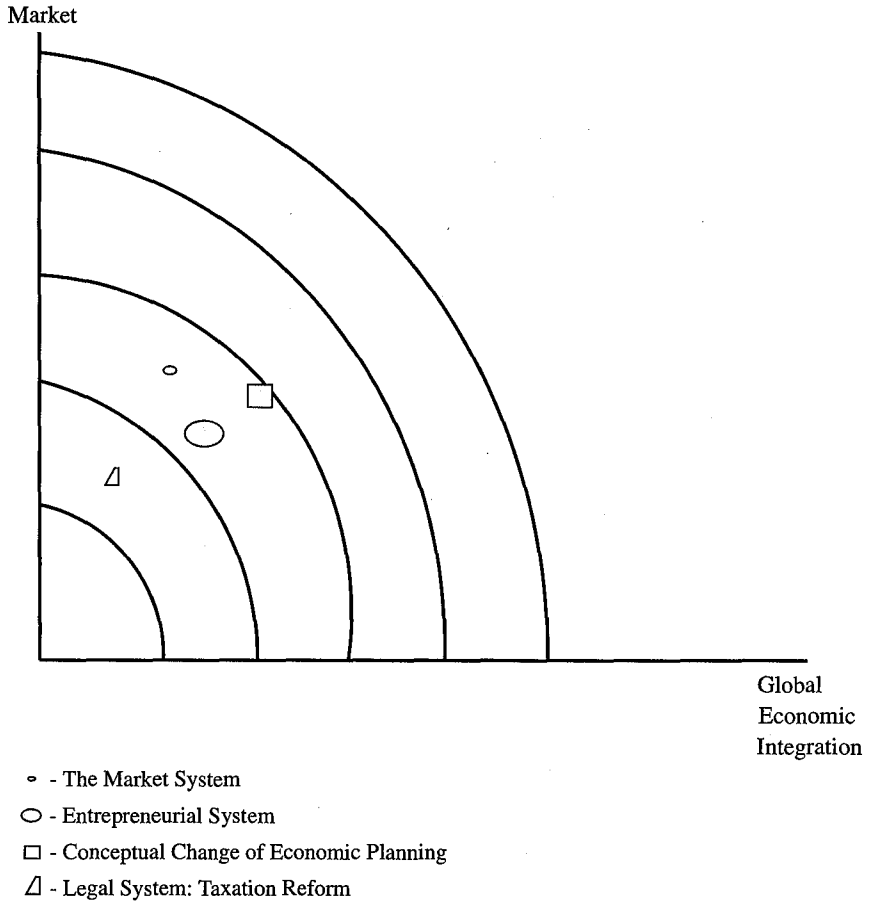
³²*China News Analysis*, December 1, 1995, 6.

³³*Hang Seng Economic Monthly*, November 1995, 1.

³⁴*Ibid.*

³⁵Friedrich A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944), 42.

Figure 2
Developmental Path of Some Ingredients of Change



factors is not static nor fixed. Their position will change dynamically vis-à-vis policy changes of the Chinese government. For example, in comparing the market system and the entrepreneurial system, the relaxation of tariff policies toward foreign goods or changing consumption patterns of individual households will increase marketization and globalization, causing a new combination. By the same token, increased privatization of SOEs in China and the invitation of foreign investment to rejuvenate SOEs will shift the curve to a new position. By imagining locational changes of the four elements, one can draw some important implications.

A market economy culture is being nurtured in China. Whether it is a state-level change of planning concepts or individual changes in consumption patterns, the effect of policy and directional changes of society will inevitably, if gradually, lead to behavioral changes in choice-making on the societal level. Some political scientists argue that "once a market economy does exist, its very presence seems to encourage some ways of life and discourage others."³⁶ In relation to people, a Chinese market economy encourages more choices, and in turn, people are induced by market forces to think and decide how to rationally distribute their savings and consumption, as well as their investments and purchases.

A second implication is that China's market has become a testing ground for its government's macroeconomic policies. Or, China may be moving toward what many political scientists describe as a "development state."³⁷ In exploring this new thinking, Jagdish Bhagwati characterizes China's economic development as "market authoritarianism," a developmental path strongly affected by the state's intervention while having the major characteristics of a market economy.³⁸ Here, the nature of authoritarianism might erode under the implementation of a market economy, planning, privatization of SOEs, and reform of the taxation system. However, it is also possible that authoritarianism can be derived from market forces.

The gap between market forces and state intervention might better be linked by the concept of a developmental state. Originally, the latter was used to describe the economic development experienced by some East Asian countries, with heavy government intervention, public-private sector links, and a strong bureaucratic capacity being the common ingredients of growth.³⁹ If, for example, Singapore is a good case to imitate, as advocated by Deng Xiaoping, its strategies of state intervention in areas such as taxation, SOEs, and fiscal incentives can be said to resemble the above-mentioned fundamental changes in the Chinese path of development.⁴⁰ In other words, Chinese eco-

³⁶Thomas L. Haskell and Richard F. Teichgraber III, "Introduction: The Culture of the Market," in *The Culture of the Market: Historical Essays*, ed. Thomas L. Haskell and Richard F. Teichgraber III (New York: Cambridge University Press, 1993), 2.

³⁷See a review written by Ziya Onis, "The Logic of the Development State," *Comparative Politics* 24, no. 1 (October 1991):109-26. The review surveys some major political scientists' theories toward the logic of development behind some East Asian developmental states.

³⁸Jagdish Bhagwati, "The New Thinking on Development," *Journal of Democracy* 6, no. 4 (October 1995): 61.

³⁹Onis, "The Logic of the Development State," 120.

⁴⁰W. G. Huff, "The Developmental State, Government, and Singapore's Economic Development Since 1960," *World Development* 23, no. 8 (1995): 1424.

conomic development could be interpreted as a new developmental state in the making.

Finally, China's movement toward a market economy, particularly in the pursuit of information and knowledge products, might pose challenges as well as opportunities to the government. According to *Statistical Yearbook of Guangdong*, for example, there has been a constant demand for telephones and papers. If such products have a positive relationship with the establishment of an information society, the Chinese government should not neglect their existence or even societal demand for them.⁴¹ The flourishing of these items will also improve the flow of information from urban areas to the countryside, leading to more easily-generated opinions about the government. In turn, the government's effectiveness and efficiency will therefore be monitored by more people. Nevertheless, as David Apter states that "government too, requires increasing amounts of information in order to operate efficiently and carry out the recommendations of the scientists and technicians. This need results, as I have said before, in a decline in coercion, a sharing of decision-making, and a widening of accountability."⁴² In other words, to disregard the fact that information is important will deter the quality and pace of development, and the government's legitimacy, if economic development is still the major objective. In short, "societies that resist technological innovation or that cannot afford its trappings will fall back even further."⁴³

Conclusion

China's marketization has generally been confirmed by many studies: at the initiation of economic reform in 1978, China's pace toward a market economy was securely anchored in the dimensions of market forces and global economic development. The directional change of these two aspects has led to at least four major sectoral changes: namely, the change of China's entrepreneurial system from SOEs to privatization; the fortification of the market

⁴¹The statistics indicate that urban household purchases of telephones from 1992 to 1995 have maintained a high level (5.23, 10.12, 9.36, and 8.94 per 100 households, respectively). See *Guangdong tongji nianjian 1993* (Statistical yearbook of Guangdong 1993) (Beijing: Zhongguo tongji chubanshe, 1993), 411; *Guangdong tongji nianjian 1994*, 366; *Guangdong tongji nianjian 1995*, 416; and *Guangdong tongji nianjian 1996*, 414.

⁴²David E. Apter, *The Politics of Modernization* (Chicago and London: University of Chicago Press, 1965), 459.

⁴³*Foreign Policy*, no. 108 (Fall 1997): 156.

system; taxation reform; and conceptual changes in economic planning. Such changes will enhance the possibility of a mature market economy, although moving toward such an economy will by no means be clear sailing. It will be a subtle political and economic struggle to both eschew and incorporate the market culture, the policy aspects of a market, and the concomitant impact of the information revolution on China's future development.