JOURNAL
OF EUROPEAN ECONOMY
Vol. 11 (№ 4). December 2012
Publication of Ternopil National Economic University

International Economy

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MODERN ECONOMIC MODELS OF REFORMING OF NATIONAL ECONOMY OF CHINA

Abstract

China has the world's fastest-growing major economy but it has been a rocky road from socialism to consumerism. China provides us with a unique opportunity to explore the causal relationships among economic, institutional, political, and social forces and the model of reforming in an important transforming economy. In China's economic transition important structural changes are occurring at the state and firm levels, and these changes have radical implications for the structure of economic and social life in China. Gradualism and stability were the foundations of the Chinese economic reform and continue to be so for the present leadership of the country. For the Chinese leaders economic reform has priority over political reform. They acknowledge that it would be impossible to accomplish anything in an environment of political unrest. The premature introduction of markets where there was neither a culture nor the institutions for dealing with them can have catastrophic effects. And from the results obtained, we can consider the Chinese as one of the most outstanding social transformations in human history, all this within a long period of stable and peaceful social environment, except for the Tinanmen Square demonstrations in June, 1989.

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Key words:

Economic reforms, model, social transformation, market economy, foreign direct investments, transition to market economy.

JEL: E20, O1.

China's reform process has both mass and acceleration. A collision of reform and special interests must come with great force at some point in time.

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Introduction

China defines its system as a 'socialist market economy'. This means it differs fundamentally from the economy which existed prior to its 1978 economic reforms, which was modeled on the former USSR, in that economic policy is not run by administrative but by market means. China has a large and vibrant private sector – indeed the world's most rapidly growing private sector. However China differs from the US or Europe in having a sufficiently large state sector, and a nationalized core banking system, that it can directly set the economy's overall investment level – the state sector is too small in the US or Europe to achieve this. This combination of market system and state sector is what gives China its greater economic strength than the US or Europe [3].

The global crisis is forcing China's economy to become less dependent on foreign markets. Manufacturing industry has to adjust to changes in international demand. Foreign affiliates' processed exports are vulnerable to the slow-down of Western demand, while Chinese exporting firms are better placed to switch to dynamic emerging markets. China's ordinary imports have risen fast. Asia has enlarged its share in the domestic market, Europe has kept a strong position while North-America has lost ground. China has become the engine of the regional economic growth. Foreign-capital firms have played an increasing part in China's imports and industrial production. China's policy towards foreign direct investments (FDI) is at least as important as its exchange rate policy to determine foreign partners' access to its domestic market [4].

Chinese economic approach of the XXI Century

China's 12th Five Year Plan enshrines a commitment to transforming China's development model. A top priority is commitment to moving from the current low-efficiency, high-growth model of development to a more balanced approach that addresses a wider range of concerns. The targets of the new model include economic growth, structural adjustment, social services development, carbon mitigation and environmental protection, and transparency and governance reforms.

The Chinese government faces numerous economic development challenges, including:

(a) reducing its high domestic savings rate and correspondingly low domestic demand;

(b) sustaining adequate job growth for tens of millions of migrants and new entrants to the work force;

(c) reducing corruption and other economic crimes;

(d) containing environmental damage and social strife related to the economy's rapid transformation [5].

Economic development has progressed further in coastal provinces than in the interior, and approximately 200 million rural laborers and their dependents have relocated to urban areas to find work. One demographic consequence of the "one child" policy is that China is now one of the most rapidly aging countries in the world. Deterioration in the environment – notably air pollution, soil erosion, and the steady fall of the water table, especially in the north – is another long-term problem. China continues to lose arable land because of erosion and economic development. The Chinese government is seeking to add energy production capacity from sources other than coal and oil, focusing on nuclear and alternative energy development. In 2010–2011, the global economic downturn reduced foreign demand for Chinese exports for the first time in many years, but China rebounded quickly, outperforming all other major economies in 2011 with GDP growth 9,2%. The economy appears set to remain on a strong growth trajectory in 2012, lending credibility to the stimulus policies the regime rolled out during the global financial crisis. The government vows to continue reforming the economy and emphasizes the need to increase domestic consumption in order to make the economy less dependent on exports for GDP growth in the future, but China likely will make only marginal progress toward these rebalancing goals in 2012 [3].

Two economic problems China currently faces are inflation – which, late in 2011, surpassed the government's target of 3% – and local government debt, which swelled as a result of stimulus policies, and is largely off-the-books and potentially low-quality [1].

Calls for the transformation of China's economic development model are actually not new. China has aimed to improve efficiency and move from a GDP and export-oriented economy to a «wellbeing» and home-market-oriented model of growth since the early 1980s and Asian crisis in 1997, respectively. Nonetheless, previous calls for the transformation were not so successful since a self-enforcing mechanism for the transformation has failed to be established through reforms, and vested interests have formed a major obstacle to change. Now, new momentum is needed in the reform process to make the new Chinese development model a reality [1].

Strong export oriented strategy of China has been showing its amazingly positive results. China exports were worth 149.9 Billion USD in January of 2012. Export growth has continued to be a major component supporting China's rapid economic growth. Exports of goods and services constitute 39.7% of its GDP. China major exports are: office machines & data processing equipment, telecommunications equipment, electrical machinery and apparel & clothing. China's largest exports markets are European Union, United States, Hong Kong, Japan and South Korea [1].

China still runs a sizeable trade surplus. But its net exports fell in 2011 (in absolute terms) for only the third time since 2000, subtracting 0.5 percentage points from its growth. Thanks to home-grown spending, China's economy still managed to expand by 9.2% in 2011, remaining surprisingly strong even in the fourth quarter. This growth owed an unusual amount to consumption (both public and private), which contributed over half for the first time since 2001. As a consequence, the share of consumption in China's GDP edged up in 2011 after falling for ten years in a row [3].

Researching the data provided by International Monetary Fund (IMF) regarding the sources of the nation's growth the following conclusion can be made. Although capital accumulation-the growth in the country's stock of capital assets, such as new factories, manufacturing machinery, and communications systems-was important, as were the number of Chinese workers, a sharp, sustained increase in productivity (that is, increased worker efficiency) was the driving force behind the economic boom. During 1979-94 productivity gains accounted for more than 42 percent of China's growth and by the early 1990s had overtaken capital as the most significant source of that growth. This marks a departure from the traditional view of development in which capital investment takes the lead. This jump in productivity originated in the economic reforms begun in 1978 [1].

Three sets of reforms need to top the new development agenda

First and most fundamentally, are governance reforms. Without transformations in governance, the shift to a new development model will be impossible. Horizontal reforms will have to clearly define the border between government and the market by limiting government power and improving the functioning of the market. Vertical reforms will have to establish a balanced relationship between different levels of government to prevent intergovernmental opportunism [2].

Second are reforms to establish fair market competition. As long as state owned enterprises (SOEs) monopolise competition, it will be impossible to have fair markets in China. The fundamental reason why SOEs should be restructured is not, as many argue, their inefficiency, but the need to build fair, competitive markets. The American Chamber of Commerce recently stated, «The United States should focus less on China's currency practices and more on the threat to US companies posed by Beijing's support for state owned enterprises». According to them, support includes «regulatory and other barriers to promote «domestic champions» in high-tech areas such as electric cars, green energy and high-speed rail» [2].

Third are sector-specific policy reforms. These include the need to reform the distorted pricing systems for factors of production, and the tax, investment, and fiscal policy systems [2].

These reforms will not be easy to achieve while two main impediments persist. Firstly, during early reforms, benefits were spread widely throughout the community. After decades of reforms, the «cake» is much bigger, stakeholders have become diversified, and the privileges of vested interest groups have been largely institutionalized. Reforms that benefit the majority but not vested interest groups will be opposed. Secondly, easier low-level reforms have been mostly completed. What remains on the reform agenda are deeper, more difficult reforms that face even stronger resistance from vested interests [2].

New momentum is needed to overcome these obstacles. The pressure for reform that China needs is currently coming from four principal directions.

The first is the fear of economic crisis. The high-export, high-investment economy is unbalanced and unstable, and the accumulation of existing risks will become dangerous in time. Another risk is from the potential slow-down of growth. Existing risks are masked by high growth. For instance, huge local government debt is underwritten by sale of government land, the high revenue of which is based on high growth. Once growth slows down, this arrangement will be unsustainable.

Second is the need to enhance the ruling party's legitimacy. As China's economy grows rapidly the needs of its people are changing. Economic success will not be enough to guarantee the legitimacy of party rule. Korea and Taiwan are both examples in which the ruling parties were unable to sustain their legitimacy on the basis of economic success. As we can see in China, the regions with more social conflicts are not the poor regions, but the regions with a relatively more advanced economy. Reforms directed to build-democratic processes and the rule of law are needed to deepen the legitimacy of the China's Communist Party.

Third, China needs to integrate with the international community. Although China is on its way to becoming the world's economic powerhouse, this will not be enough to convince the world to embrace its success. Its values and institutions need to be acceptable to the rest of the world as well. The boycott of the Olympic torch relay and some rejections of attempted overseas acquisitions by China's SOEs exemplify the difficulties faced.

The fourth driver for momentum is regional competition. Scholar Baechler argues that competition by political units with the same cultural background in Western Europe led to the development of modern growth and constitutional rule. Some analysts see competition among ambitious regional leaders in China as potentially providing a similar impetus for economic growth and institutional evolution [5].

Regional institutional experiments have been emerging throughout China in the last few years. These include land reform in Chengdu, grassroots elections in Jiangsu and Yunnan, crackdowns on organised crime and the promotion of «red» (revolutionary) songs in Chongqing, free medicare in Shenmu, official property openings in Aletai. The successes and failures of these pilot reforms are valuable learning experiences for other regions, and for national institutions [5].

Social and education reforming

China will make further efforts to improve compulsory education for the children of migrant workers, Education Minister Yuan Guiren said in February, 2012. Yuan said that children who follow their parents to study and live in cities will be included in the financial security system and considered in the regional education development plan.

Children who are separated from their working parents and are attending schools in their hometowns will be given priority at boarding schools in rural areas, Yuan said.

According to the Ministry of Education, the central government has invested 28 billion yuan (US$4.5 billion) over the last three years into reinforcing the construction of 300 million square meters of dormitory space which had potential safety hazards [3].

New challenges in 2012

China's economic diplomacy will face growing challenges in the form of trade and exchange rate disputes, as well as the task of protecting overseas investment interests, over the next few years, experts said in February 2012.

2012 will be an election year for the United States and France, and there is an increasing possibility for the two countries to use the "China threat" as an excuse for not dealing with their own economic issues, which will put Chinese diplomacy under pressure, said Ding Yifan, deputy director of the Institute of World Development of the Development Research Center of the State Council at a seminar on Chinese diplomacy [6].

During the first half of 2012, several countries will remain in a grave debt crisis and may even see their crises deepen, Ding said, adding that this situation may create friction between China, the United States and Europe.

Additionally, protecting China's growing overseas investments will pose new challenges for the country's diplomacy, Ding said.

Chen Fengying, director of the Institute of World Economic Studies under the China Institutes of Contemporary International Relations, agreed that the protection of China's overseas investment interests will be an important task for Chinese diplomacy [6].

During the past three decades, China has invested in more than 170 countries and regions, with outbound direct foreign investment topping $170 billion. Also China has been focused on "bringing in" foreign investment; it may do more to facilitate its "going out" in the future, Chen said [7].

Chinese economic diplomacy will serve the country's economic construction and the protection of its overseas interests, national interests and security, Chen said, adding that China's position in the world is closely related to its economic diplomacy.

Chen said China has made several achievements in international economic governance, reflected by China's growing influence in the international arena and the posts held by Chinese officials in important international organizations [7].

Conclusions and the closing remarks

Although China occupies a unique niche in the world's political economy-its vast populace and large physical size alone mark it as a powerful global presence-it is still possible to look at the Chinese experience of effective reforming of economy and draw some general lessons for other developing countries. Most important, while capital investment is crucial to growth, it becomes even more potent when accompanied by market-oriented reforms that introduce profit incentives to rural enterprises and small private businesses. That combination can unleash a productivity boom that will propel aggregate growth. For countries with a large segment of the population underemployed in agriculture, the Chinese example may be particularly instructive. By encouraging the growth of rural enterprises and not focusing exclusively on the urban industrial sector, China has successfully moved millions of workers off farms and into factories without creating an urban crisis. Finally, China's open-door policy has spurred foreign direct investment in the country, creating still more jobs and linking the Chinese economy with international markets.

China's strong productivity growth, spurred by the 1978 market-oriented reforms, is the leading cause of China's unprecedented economic performance. Despite significant obstacles relating to the measurement of economic variables in China, these findings hold up after various tests for robustness. As such, they offer an excellent jumping-off point for future research on the potential roles for productivity measures in other developing countries.

Despite the good intentions behind these projects, the success of reform schemes will continue to be haphazard in the absence of strong rule of law, and checks and balances on government power. Regional experiments tend to be initiated, controlled, and dominated by strong regional leaders, so there is probability that some initiatives might lead to bad outcomes and high social costs if these strong leaders make poor decisions or simply pursue populism. Government economic opportunism presents another serious challenge, but without the kind of civil society that can flourish under strong rule of law, it will be difficult to curb government power.

The reality is that China's experiment with market reform has propelled her into the top 3 trading nations in the world. Over the past two decades, China has achieved the fastest economic growth of any national economy. If that growth continues, China could become the world's largest economy during the first half of the 21st century. The World Bank estimates that by 2020 China could be the world second largest exporter and importer and its consumers may have a purchasing power larger than all of Europe's. She is becoming the biggest economy in the planet with a population whose main objective in life is to become prosperous. The fact is that China is changing so fast that is difficult to keep abreast of developments. Furthermore, China is a maze of intricacies, complexities and contradictions. As Deng Xiaoping declared in 1985: «(The Chinese reform) is a great experiment, something that is not described in books» [3].

China's economic miracle is the result of three decades of reform. As its economy grows, it is reaching a crossroads with its development model. Whether China will continue its modernization through transforming its development agenda depends on whether it can overcome the challenges presented by vested interests. New sources of momentum will therefore be needed to overcome these challenges and continue reform.

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The article was received on July 17, 2011.