The Institutional Development of a Changing China

The notion of economic growth and its causes has been under scrutiny for centuries. Some try to explain it using the theories of physical and human capital accumulation. Others place a large emphasis on technological progress and advancement. However, over the last two decades, there has been a tremendous amount of growth within China, and experts are stating that it has been due to the changes made in China’s institutions and various policies. Originally a Soviet-type centrally planned economy, China has become a more open market type of economy that has a rapidly growing private sector, propelling it into the center of the global economy. This paper will take a closer look at the old institutions and policies that mitigated growth, along with the changes by the government that brought China under the magnifying glasses of many economic experts.

According to The Economist, “China was not only the largest economy for much of recorded history, but until the 17th century, it also had the highest income per capita — and was the world’s technological leader”. China remained the largest economy until the late 1800s, and even up until 1820, China accounted for 30% of the world’s GDP. Until then, China had been primarily an agrarian economy and culture, mostly made up of landlords and farmers. However, after the downfall of the Kuomintang in 1949, the Chinese Communist Party redistributed the land of the wealthy into the hands of the peasants, and enacted a social and economic plan, “The Great Leap Forward,” aimed to transform China from a primarily agrarian economy into a modern, industrialized communist society rival to the US. Unfortunately, the plan was a major economic disaster. The Government took control of the agricultural sector hoping to take advantage of low purchase costs, and high selling prices, but due to a set of natural disasters, along with a large reduction in efficiency due to the large collectivization of

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1 http://www.theglobalist.com/countryoftheweek/sample.htm
2 http://www.economist.com/printedition/displayStory.cfm?Story_ID=3219418
the farms, there was a massive decline in agricultural output, which lead to a widespread famine and death.

While major changes in the agriculture sector were made to restore original output levels of grain such as a partial restoration of a market economy, the next major toll in China’s return to economic power came with the Cultural Revolution. Virtually all engineers, scientists, technicians, and other professional personnel were “criticized,” demoted, “sent down” to the countryside to “participate in labor,” or even jailed, all of which resulted in their skills and knowledge being lost or rendered useless and “a 14-percent decline in industrial production in 1967.” There was also rampant xenophobia, which closed the doors to imports of foreign technology and equipment, which were vital for technological advancement. All universities were shut down, creating a large lapse of educated people in the population. Besides losing the title of technological leader, China established policies in Industry that froze wages, cancelled bonuses, featherbedded in order to absorb unemployment, and hired workers on a permanent basis, essentially eliminating incentives to work hard. During these two periods (1960-1962 and 1967-1968), China’s real annual growth rate dropped 33.2% and 9.8% respectively.

Despite the atrocious growth rates that occurred during that decade, China responded with many institutional and political reforms that allowed China to gain a double digit average growth rate over the last three decades. The first major economic reform began in 1978 and established a “household responsibility system” in agriculture, whereby local managers are held responsible for profits and losses. Farmers were still given a quota to produce, maintaining the socialist aspect, but the quotas were greatly reduced from years past, and any surplus in output was allowed to be sold on a free market economy.

3 http://countrystudies.us/china/90.htm
4 http://www.chinability.com/GDP.htm
market with unregulated prices. The instant success of this program helped to bring the poverty rate down from 53% of the population during the Mao era to 8% in 1981.

Perhaps the two most important changes were the opening up to foreign direct investment and trade, and the establishment of a private sector. In the past, the ideology of China was the notion of self-sufficiency. Before the reform period, the combined value of imports and exports had seldom exceeded 10% of national income. However, after an “open door” policy was established, in 1980 imports and exports was 15%, in 1984 it was 21%, and in 1986 it reached 35% of national income. The development of privatization in China was relatively slow compared to other economies transitioning from centrally planned to free market. “According to the World Bank (1996), the share of the private sector in GDP was about 70% in the Czech Republic, 60% in Poland... but only 28% in China.” This is largely due to the fact that many firms and enterprises were essentially privatized, though they were still formally under the name of collective ownership for political protection and economic benefits. This is referred to as hidden privatization, “which could be explained by the lack of legal and institutional protection to private property rights at the early stage of economic transition.” However, once property rights were more openly established after 1992, not only private-owned enterprises, but also share holding companies, cooperatives, joint-enterprises and enterprises with foreign direct investment began developing rapidly. The next four years produced an average annual growth rate of 12.7%.

With this much growth, it is easy to see how much the changes in China’s governmental policies and institutions played a part. In order for the private sector to grow as much as it did, there must have been a high degree of property right protection, rule of law, and “tolerance of the local governments to

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Comment [D3]: Again, a lot of the material in this paragraph and the next one is in Chapter 12.

Comment [D4]: I don’t know if it was that there was a high degree of rule of law so much as that the degree of rule of law was so much higher than it had been. Remember, China in 1980 was starting from a very low base.

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6 http://countrystudies.us/china/92.htm
7 http://dx.doi.org/10.1016/S0939-3625(01)00007-3
the private sector and the extent of local entrepreneurship.\textsuperscript{8} Also, the political changes within China, specifically the opening of its borders to foreign investment and trade allowed for a decrease in the technology gap between China and the technological leaders of the world. China’s economic surge is undeniable, as is the importance of its institutional development.

\textit{ZZZZZ,}
See comments in text. This essay is disappointing. Most of the ideas in it were in the textbook already. You have fleshed out some of the institutional improvements that took place in China following Mao’s death, but you haven’t really added to the already presented idea that institutions got a lot better, and that this unleashed a period of rapid growth.

Grade: 40 [Mean was 62]

\textsuperscript{8} http://dx.doi.org/10.1016/j.jbankfin.2007.11.016