

## CHINA'S ECONOMIC REFORMS DURING 1993-2013

Liviu-Alexandru MICU

Academy of Economic Studies, Bucharest 077125, Romania  
liviumicu2009@gmail.com

### Abstract

*The socialist market economy is the economical system used by the People's Republic of China.*

*This type of economy is based on the prevalence of the state system, which permanently interacts with an open market economy. The rationale behind the initiation of such an economical system is the fact that China economy was in an early stage of capitalism, and the principles of capitalist development would have been able to bring prosperity, according to Deng Xiaoping opinion. He wanted to insert market inside the planned economy, and he finally managed to succeed by creating the concept of "State capitalism". In this paper I will highlight the main reforms of the Chinese economical system, during 1993-2003, outlining the way followed by China from a controlled economy to a market one.*

**Key words:** reforms, socialist market economy, economical system, monetary policy

**JEL Classification:** P31, J43, B24

### I. CHINA'S ECONOMIC REFORMS DURING 1993-2013 (JIANG ZEMIN)

After the XIV-th National Congress of the Chinese Communist Party, which entered history as the first congress to establish the target of building a socialist market economy in China, Jiang Zemin has been elected as president of the republic. The socialist market economy is the economic system used and developed by the People's Republic of China, led by president Jiang Zemin.

In 2000, Chinese president Jiang Zemin announced his own doctrine of "Three Represents", declaring that CCP invited private entrepreneurs and rich persons to join the Party, and even to participate in the central power (which contradicts certain orthodox Marxist canons). Some Chinese rural zones began to organise democratic local elections. Nobody denies that, during 1993-2013, the situation in China stabilised, and the country transformed from a radical one (led by "proletarian dictatorship") into a more modest state-nation (with "four modernisations"). Also, the survival and success of any Chinese company, no matter whether it is owned by the state or not, is depending on its performances on the market. China made efforts towards integration into the global community. As its hybrid economy began to come into prominence, and its economic government became more and more decentralised, the country drew more and more away from the precedent authoritarian system.

In 1994, China introduced a major tax reform, which:

1. Established a clear distinction between national and local taxes;
2. Established a national tax agency, and local tax agencies, each being responsible for its own tax collection;
3. Transformed value-added tax (VAT) into the main indirect tax collected by the central administration, and shared by local administrations in a fixed quota of 75/25. (Fischer 1996 pp 390-395)

Before this reform, China had no national tax agency; all taxes were collected by local administrations. These ones frequently reduced or eliminated taxes that should have been paid to the central administration. The tax reform made it difficult for local administrations to reduce national taxes, like they did in the past. It introduced a series of fixed tax target figures between national and local administrations. It also led to the reduction of local budget income quota in official "budgetary" and „extrabudgetary“ accounts.

In spite of the fact that the tax reform is hindering the budgetary tax restraints of local administrations, it does not eliminate the main income sources of these ones. Besides 25% of VAT, the incomes of local administration come from the tax on companies' income (except for the state ones, which are controlled by central administration), the tax on personal income and other taxes for legal persons. Also, an important source of income for local administrations is represented by unofficial "extra-budgetary" accounts, which are not registered and cannot be monitored by central administration. According to a recent study (Yang 1996), these accounts have sizes almost equal to official "budgetary" accounts of some provinces.

In 1995, the new Budget Law became effective. This interdicted to central administration to make overdraft at the central bank, and to finance by deficit the current account. The central administration could finance by deficit its capital account, but financing had to be obtained from governmental bonds. For local administrations, the requirements were even more severe. No matter of their level, local administrations had to

have a balanced budget, and, besides that, the law strictly controlled bond emission, and restricted the loans given to local administration on the financial market(Zhang Le-yin 1999).

By the end of 2008, Chinese governors completed a balance of the last 30 years, highlighting the role of macroeconomic policies elaborated by the government. Based on the conclusions of this report, published in “China Daily” daily paper, the governors announced that, due to the economic crisis, a change of approach is required, beginning with the “tax cautiousness” adopted in 2008, and continuing with the strict monetary policy during this period of global crisis. The following resulted from the balance:

- During 1991-1997, China followed restrictive monetary and tax policies, interest rates have been reduced, the money flow on the market was extended in order to revitalize economy, but inflation rate registered a record, reaching 21,7% in 1994. The government succeeded to bridle price boost, by maintaining the increase of money offer and the tax expenses at a moderate level.
- During 1998-2003, China adopted an active tax policy and a “prudent” monetary policy, thus trying to counteract the effects of the financial crisis in Asia, which took place during that period. The measures targeted the increase of income for persons with reduced fruition, stimulating mainly the internal demand. As it reduced interest rates, the government began to tax deposit interests, and to adjust money demand through open market operations of the central bank. The government also intervened by reducing its own expenses, contracting more debts for financing investments into infrastructure.

In 1997, the state decided to extend privatization at large scale state companies, continuing also economy restructuring. So, it targeted 100 large-scale state companies, in order to determine them to diversify their monopoly-type property, even though 80 of them subsequently remained state companies, mainly because of the numerous problems impacting privatization experiments (according to Jiao Jihong 2002). As a rule, the old authority of a state company included the party committee, the worker’s syndicate, and the administrative body of the respective unit. The state hoped that, as along as the new authority of a state company was composed of a boarding committee, a shareholders’ committee and supervisors, many of them coming from outside the company, the economic performances will increase. Still, creating a new authority was prone to rise many problems. Even when, in 1998, some of the large-scale state companies have been sold, a series of problems associated to privatization - e.g. deficient operation, management and accounting practices - has been exposed, because managers and administrators didn’t have enough experience, scientific knowledge and managing competencies.

Such problems, persisting from the beginning of privatization in China, maintained the rate of GNP at a moderate 7-8% level in 2000-2001(Yearbook 2004). After China’s admission to WTO, privatization became even more complicated, because it had to face a global acerbic competition. In fact, some transnational companies intended to give up financial services and joint partnerships with China, because of even higher risks and costs associated to capital investments. To this line, the pressure towards privatization exercised by China also reflects the new urgency of observing WTO international standards. China’s reforming elite actively used its admission to WTO for generating a new blow regarding additional reforms, reinforcing “The law of companies”, diversifying the property structure of large-scale state companies, and building modern structures of corporate governance in China.

Still, the long-term problems of privatization in China are deep-rooted in entrepreneurial culture, due to the lack of transparency and transparency stimulation in state companies. So, as privatization in China is continuing to destroy the predominance and monopoly of state companies, judicial system reforms are beginning to play a fundamental role. In March 1999, China’s Constitution has been again modified. It is the fourth change since 1982. Both private property, and rule of law have been officially integrated into the Constitution, underlining that private companies are a compulsory component of China’s economy (Zhang,Zhu et.al 2005). In 2001, CCP proudly declared that it was the first communist party in history to voluntarily allow private entrepreneurs to join the party. Chinese president Zhiang declared that CCP was representing all people in China, not just some of them, and that private owners and rich people were welcomed to join the party.

In order to accelerate its access to the market by means of privatization, China might need more than ever that its institutions learn from the past and from the examples of foreign states. The acerbic market competition imposes balancing of economic concerns, by means of compensation policies and by approaching market failures associated to the rapid growth of unemployment and public debt.

## II. CHINA'S ECONOMIC REFORMS DURING 2003-2013 (HU JINTAO)

On November 15<sup>th</sup>, 2002 at the first Plenary Session of the XVI-th Central Committee of the Chinese Communist Party, which took place at Beijing, Hu Jintao has been elected as General Secretary of the party and President of China. During the congress, there have been references to building a moderate wellbeing society, and creating a new situation in the development of socialism with Chinese features (Yin, 2012 pp 189-190).

Although this economic system brought China on the second place of the largest economies in the world, at internal level, dissatisfaction at population level is continuing, because the society is strongly biased, which led to the advent of such tendencies as The New Left; this current is composed of old-school socialists, who consider the present system a forced march toward market economy and private property.

On this background, since his coming into power, president Hu Jintao has been trying to create himself an image of left-oriented person, who is fighting hard for re-establishing balance at society level, taking measures in favour of poor people, and supporting the emergence of a solid middle class (Zhang and Cooper, 2010, pp 178-192). So, Hu Jintao is strongly financing scientific research in order to introduce official socialist ideology into the contemporary era, and is drifting away from the policy of its predecessor, Jiang Zemin, who allowed businessmen to join the Communist Party, thus creating its look as a leader supporting politicians "with relationships", while trying to acquire public properties.

The 2002 and 2007 congresses debated the directions of long-term economy development, targeting:

- The activation of modernization process
- The progress and transformation of economic structures
- The improvement of socialist market economy
- The vigorous promotion of computerization
- Ensuring a healthy and lasting development of the economy, in order to continuously improve the population's standard of living
- Development of rural economy, and stimulation of urbanization process; consolidating the position of agriculture as base of national economy, reforming structures in agriculture and rural economy, ensuring agricultural production and increasing cereals production, increasing the competitive power of agriculture on the market.
- Maintaining and improvement of the basic economic system, and extending the reform of state properties administration system
- Deepening the reform of the income repartition system, and accomplishing the social protection regime
- Creating new workplaces for the population

Extending the horizon towards outside, by introducing as many as possible external resources into the economic circuit, and exporting an increasing larger amount of finished articles ([www.csis.org/blog/china-economic-reform-timeline](http://www.csis.org/blog/china-economic-reform-timeline)).

During 2004-2008, the credit and fixed assets for investments increased excessively, which led to China's passing into a new phase of macro control, in order to prevent economy overheating and inflation advent. So, in 2005, the authorities changed the tax policy, passing for two years from an active one to a cautious one, and also adopted a restrictive monetary policy.

In the future, China will have to concentrate more on rising tax income by means of tax reforms, on creating additional channels for tax collection, on improving competition quality by means of financial reforms, on eliminating bad loans, on accentuating the fluidity of bank capital, on asset selling, on reducing bank credits for state companies, on recapitalization of state companies, etc.

**Table 1. Main steps of the China transition**

Time table and events	Strategic objectives	Institutional reforms: strategies and measures
Phase I 1978-1980 (transition initiation)		
The third plenum of the Central Committee of the Eight Congress of Chinese Communist Party(Jiang, 2002, pp 539-540)	Revitalizing agriculture sectors Changing priorities from political directives to economical ones Allowing ownership of small land surfaces	<ul style="list-style-type: none"> <li>- Initiating the responsibility system for rural households</li> <li>- Adjusting the price of agricultural products</li> <li>- Adopting the law regarding joint ventures</li> <li>- State companies are allowed to sell and buy on the free market</li> <li>- Opening four special economic zones</li> <li>- Experimenting land leasing</li> <li>- Beginning to reduce the coverage of the materials distribution system (Lili, 2012,pp20-21)</li> </ul>
Phase II 1980-1984 (concentrating on economic efficiency and leadership of state policy)		
Priority for economic efficiency	Introducing measures for market orientation, and new industrial policies; reinforcing accomplishments obtained from agricultural reforms	<ul style="list-style-type: none"> <li>- Beginning the reform of commercial system: de-regulation of inputs/outputs and privatization of state commercial and services companies</li> <li>- Price liberalization, by introducing the second price system for industry, raising rough price ceilings, followed by their elimination (1985)</li> <li>- Progressive prolongation of the land leasing contract periods</li> <li>- Administration of agricultural commerce, in order to tax rice producers and to subsidize wheat consumers</li> <li>- State companies are allowed to directly commercialise their products</li> <li>- Local governments are allowed to create industrial companies</li> <li>- Tax reform for creating four new indirect taxes</li> <li>- Reforming company tax system – replacing profit rendering to the state by partial taxation of profits, depreciation and post-taxing profits being held by companies</li> <li>- Eliminating the interdiction to create foreign trade companies</li> </ul>
Phase III 1985-1993 (the reform of state institutions)		
Beginning institutional reforms in some key branches	New measures in: financial, taxing and judicial sectors; progressive diversification of industrial units ownership, in order to reinforce the private sector	<ul style="list-style-type: none"> <li>- Introducing the fiscal responsibility system, based on a contract between central government and local ones</li> <li>- Temporary re-assessment of price and internal trade control during stabilization (1988-1989)</li> </ul>

<p>China is putting in for the General Agreement on Tariffs and Trade (1991)</p>		<ul style="list-style-type: none"> <li>- Temporary relaxation of price and trade control (1990-1992)</li> <li>- Increasing planned prices towards market level, in order to unite the dual price system (1988-1992)</li> <li>- Price reform for grains and seeds, in order to convert subventions for agricultural products into income for farmers (1991-1992)</li> <li>- Progressive extension of the role of market prices for industry (1985-1988)</li> <li>- Relaxing compulsory production plans in agriculture, in favour of acquisition contracts (1985-1987); progressive relaxation of restrictions regarding inter-regional and international trade of agricultural products</li> <li>- Transferring to local governments the remaining price controls for most consumer goods (1986); price liberalization, according to local conditions</li> <li>- Establishing a national level centre of foreign trade, open for all companies in order to buy and sell at variable exchange rates (1988-1992)</li> <li>- Reducing the price difference between black and official market to just 6% till 1991, compared to 100% during previous years</li> <li>- Establishing a contract system in commerce (1988)</li> <li>- Elimination of central subventions for export; increasing the currency quota retained at local level; acceleration of trade reform (1991)</li> <li>- Introducing industrial goods markets, beginning with 1987</li> <li>- Legalization of the transfer of land use rights (1988) (the mechanisms for land market easing appeared in 1991, and this market is not yet functional)</li> <li>- Adopting the responsibility system for contracts (1987) with 3-5 years contractual due dates</li> <li>- Adopting the law of companies (1988)</li> <li>- Temporary confinement of company reformation, in order to reduce investments at all levels (1988-1989)</li> <li>- Merging 3000 inefficient state companies with other ones (1991); relaxing the constraints regarding</li> </ul>
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		<p>direct crediting, initiating companies reform</p> <ul style="list-style-type: none"> <li>- Increasing the autonomy of state companies, by means of new functional mechanisms (1992)</li> <li>- Adopting the law of bankruptcy (1987)</li> <li>- Creating share markets (1989-1992), first for secondary transacting state bonds, then for shares (Shanghai 1990, Shenzhen 1991)</li> <li>- Simplifying government structure using the “Xiagang” system (since 1992)</li> </ul>
Deng Xiaoping’s Southern Tour		
Phase IV 1993-2013 (orientation towards competitiveness, concerns regarding the quality of economic growth, reconstructing the rule of law)		
Deepening the general institutional reforms	Privatization of the state sector beginning with 1994	- Privatization of small and medium state companies at local level, after 1994
		<ul style="list-style-type: none"> <li>- Selecting 100 big state companies for experimenting privatization (1997);</li> <li>- Accelerating global reforms of state companies: stock exchange listing, buying, acquisition and merging, initial public offers, etc. (2000);</li> </ul>
	Reforming the structure of shares property:	<ul style="list-style-type: none"> <li>- Diversifying property, in order to include shareholders (1993);</li> <li>- Opening the shares and bonds market (2001);</li> </ul>
	Taking compensation measures and making additional structural adjustments at market relationships between demand and offer level;	<ul style="list-style-type: none"> <li>- Rethinking budgetary plans and investments structure (1995);</li> <li>- Suspending overproduction projects (1995);</li> <li>- Tax exemption for main import capital products and for investment funds (1998);</li> <li>- Adjusting the interest rate, the exchange rate, etc. (2000)</li> </ul>

The Asian financial crisis in 1997	Rationalization of the regulating frame, for transparency, justice, cohesion;	<ul style="list-style-type: none"> <li>- Creating the Securities Regulatory Commission (CRSC) (1993), and extending fraud investigations;</li> <li>- Restructuring the financial sector and system;</li> </ul>
	Building the rule of law;	<ul style="list-style-type: none"> <li>- Reinforcing disclosure requirements for companies listed at the stock exchange (2000);</li> <li>- Introducing standards and regulations for telecommunication and for technology encryption (2000);</li> </ul>
Zhu Rongji becomes prime minister in 1998	Initiating substantial reforms in financial and fiscal sectors (1994-1996); adhering to capital markets	<ul style="list-style-type: none"> <li>- Reform of the banking system (1998): transforming bank property, e.g. through swap programs of transforming debts into capital (2000), by means of acquisitions and merges, allowing foreign companies to penetrate the banking services, opening the internal interbank market, introducing regulating demarcation between banks, insurance companies and brokers;</li> <li>- Fiscal system reform in order to counteract deflation, stimulating market demand and mass consumption (1998);</li> <li>- Reforming the internal bond market (2000);</li> <li>- Commitment to a laxer tax policy (2001);</li> <li>- Introducing tax relaxations for protecting incipient and fundamental industries;</li> <li>- Preparing for a stock exchange centre similar to Wall Street (2001);</li> </ul>
	Extending financing sources and the income base;	<ul style="list-style-type: none"> <li>- Attracting funds through initial public offers and market recapitalisation; bonds, securities, shares, treasury bills, insurances, etc.; (1995-2013);</li> <li>- New provisioning strategies, including e-commerce solutions;</li> </ul>
	Rigorous restructuring of industries in China (beginning with 1998);	<ul style="list-style-type: none"> <li>- Open competition in fundamental economic sectors;</li> <li>- Introducing stimulants for telecommunication and internet owners, for foreign investors;</li> </ul>
China is joining WTO in 2002	China's complete opening to global markets;	<ul style="list-style-type: none"> <li>- Ensuring complete observance of the norms regarding WTO membership (2001);</li> <li>- Continuing reforms in the judiciary system (beginning with 1998);</li> </ul>

		<ul style="list-style-type: none"> <li>- Currency reform towards complete convertibility (2007);</li> <li>- Inviting renown researchers from abroad to teach in universities, and calling back people born in China (2008-2013);</li> </ul>
China is transforming the world-level financial crisis into an opportunity, by acquiring long-term resources from countries like Brazil, Russia, and African states	The increase of citizen's participative role; Establishing a new social security system, in order to ensure workers' rights, and protect them against market dysfunction;	<ul style="list-style-type: none"> <li>- Developing a national social security system (1995-2013);</li> <li>- Reforming the pension system, and preparing for importing foreign management of pension funds on securities market (2008);</li> <li>- Continuing anti-corruption campaigns (2008-2013);</li> <li>- Confirming agreements on human rights (2001);</li> <li>- Increasing tax stimuli for boosting economic growth and observing social security obligations (2001-2009).</li> </ul>

(Source: Author Processing)

As we can see in the above table, institutional reforms in China developed in a thorough and extended manner, significantly modelling the country's transition process. From macro-institutional perspective, the reforms implied six phases:

- 1) Structural adjustment of industrial policies at the beginning of the transition; for example, agriculture subsidies after prior excessive restriction, as well as reducing subventions for state companies, and gradual elimination of export subvention;
- 2) Early creation of efficient mechanisms for stimulating and promoting rural and urban entrepreneurship, by means of accentuated budgetary coercion, accelerating access to the market, integrating state sectors, and diversifying industrial structures in order to develop non-public sectors, like the private sector, urban and communal companies, and joint ventures, including local joint ventures with global capital, etc. In the meantime, the state ensured enough protection for its scale economy, for fundamental and incipient industries, including strongly technological industries and with high value-added level, such as communication and information technology, and essential programs for research and development acceleration, etc.;
- 3) Beginning with the mid 1980s, creating an efficient and resistant macro-economic governance system, through bureaucratic decentralisation and economic de-regulation, including relaxing price control and promoting managing independence and local activism. Finally, these de-centralisation and de-regulation measures weakened the ideological rigidity and hyperactive bureaucratic interventions of the previous planning system, stimulating the role of market competition, which is leading towards economic growth and horizontal and vertical integration;
- 4) Opening towards world economy, by means of accelerated economic liberalization, for example by the introduction of a rural household responsibility system (beginning with 1979) and (beginning with the mid 1980s) allowing the transfer of land using rights and introducing commercialization into state companies. Beginning with the mid 1990s, the state reformed the financial and tax sectors in China, and opened capital, bonds and securities markets, for new capital acquisition . Also, the state tried to transfer funds attracted from the banking sector on capital and securities markets, and, in the last part of this period, it tried to extend its income base by emitting M2 monetary supply and initial public offers, thus preparing for currency convertibility, majoring the foreign shareholders' capital in some fundamental industries, and adopting flexible monetary and commercial policies, including floating interest rates and exchange rates, etc. All these measures have been supported by aggressive reforms of the tax and financial systems, in order to reinforce market competition in the global space, and to stimulate free circulation, facilitating the accumulation of physical capital.
- 5) State sector privatization – beginning with the mid 1990s till 2013, China permanently implemented daring reforms of the state sector, heading towards state companies privatization as engine of its transition.
- 6) Rationalisation of the Chinese judicial and economic governance systems, by setting up since 2000 a set of new laws regarding finance, global trade, prices, taxing, investments, bankruptcy and

companies, and by setting up a set of new laws regarding knowledge and information, intellectual property rights, information technology, etc., during 2000-2013. Enforcing the rule of law also facilitated the creation of new fundamental market institutions, including China Securities Regulatory Commission (CSRC), the contracts system and labour market management, innovative systems for distribution on product and capital markets, as well as implementing these decisions by means of agents, brokers and other mediators, etc. Setting up a rational bureaucracy in China, and the development of social expenses sector significantly contributed to the macro-institutional media of the Chinese economic system, also facilitating the transition of this country. In order to reinforce these measures, beginning with 2004, the government repeatedly launched anti-corruption campaigns, aiming efficient governance and an “honest” reputation, which continued during the whole period of Hu Jintao presidency.

Among all changemend efforts presented above, opening, entrepreneurship, flexibility, sustainability and stability distinguish themselves as the pillars of institutional reforms in China, and as major points regarding this country’s transition. Transition also involved liberation, to a certain degree, from the restrictions imposed along time by the Communist Party, in its attempt to control the country’s economic system. However, the question is still open: Does China progress towards a market economy?

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