

## **The Contributions Made by the Economy Reform and Private Sector for the Rapid Economic Development in China**

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### **Abstract**

The People's Republic of China is now the world's second largest economy after the United States and the world's fastest-growing major economy, with an average annual growth rate of 10% from 1978 through 2005, according to official statistics.<sup>1</sup> It is also the second largest trading nation in the world and the largest exporter and second largest importer of goods. In more than 50 years since the founding of the People's Republic of China in 1949, Chinese economy has undergone an unusual development process, passing through socialist heavy industry development strategy and economic reforming and opening-up strategy. Due to the reform and opening-up policy China has attracted foreign direct investment, increased its productivity and raised its economic efficiency by introducing profit incentives to rural collective enterprises, family farms and private businesses. There are some economic development models in China's private sector. Among those the Wenzhou economic model is the most successful one.

**Key words:** Chinese Economy, Economic Reform and Opening-up Policy, Wenzhou Economic Model

### **Brief Introduction about the History of Economic Development in China**

***Economic situation of newborn China:*** In more than 50 years since founding of the People's Republic of China in 1949, China has undergone an unusual and tumultuous development process, passing through revolution and socialism. During the initial stages, China followed a socialist bias heavy industry development strategy. Consumption was reduced while rapid industrialization was given high priority. The government took control of a large part of the economy and redirected resources into building new factories. Entire new industries were created. Most important economic growth was "jump-started". Tight control of budget and money supply reduced inflation, and it was done at the expense of suppressing the private sector of small to big businesses.

***Economy reform from 1978:*** China began to make major reforms to its economy since 1978. The Chinese leadership adopted a pragmatic perspective on many political and socioeconomic problems, and sharply reduced the role of ideology in economic policy. During this period China took several remarkable steps to improve the living standards, social conditions, and relative social stability. A decision was made in 1978 to permit foreign direct investment in several sectors of the economy and establish "special economic zones" to bring down the cost of manufacture. The country lacked the legal knowledge of international practices to make some of the projects attractive to many foreign businesses. However, in the early 1980s steps were taken to expand number of areas and related efforts were made to develop the legal and other infrastructures necessary to implement investment projects successfully. This additional

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<sup>1</sup> Barry Naughton, *The Chinese Economy Transitions and Growth*, the MIT Press, Cambridge, 2006, p3.

effort resulted in making 14 coastal cities and three coastal regions "open areas" for foreign investment. (Lu Yusheng, 2009). All of these places provide attractive tax treatment and other facilities for foreign investment. Laws on contracts, patents, and other matters of concern to foreign businesses were also passed in an effort to attract international capital to spur China's development.

***The present development of economy:*** China launched its Economic Stimulus Plan to specifically deal with the Global financial crisis of 2008–2009. It has primarily focused on increasing affordable housing, easing credit restrictions for mortgage and SME, lower taxes such as those on real estate sales and commodities, pumping more public investment into infrastructure development, such as the rail network, roads and ports etc. By the end of 2009 Chinese economy was showing signs of recovery. At the 2009 Economic Work Conference held in December focused on "managing inflation expectations" was added to the list of economic objectives, suggesting a strong economic upturn and a desire to take steps to manage it (Ma Jun, 2009). By 2010 it was evident to outside the world *The New York Times* says that "China was poised to move from export dependency to development of an internal market". Wages were rapidly rising in all areas of the country and Chinese leaders expected for an increased standard of living.

In mid-2010, China became the world's second largest economy, surpassing Japan's economy and second only to the economy of the United States. In the second quarter of 2010, China's economy was valued at \$1.33 trillion, ahead of the \$1.28 trillion that Japan's economy was worth. According to preliminary estimates, China's 2010 total GDP to be worth \$5.7 trillion. It is said that, sometime China would reach to the world's largest economy (by nominal GDP) by 2020. China is the largest "creditor" nation in the world and owns over 25% of US Treasury Bonds.<sup>2</sup>

### **Chinese Economic Reform**

Chinese traditional society was overwhelmingly rural, each government in different dynasties paid special attention to the agricultural sector and most of the economic policies were formulated for the betterment of the agriculture, it is the main sector which support the whole economic system of China, Looking backward to the history of economy, it is easy to find out that the huge changes introduced to the economic policies for the improvement of the economy took place in 1978. Since then China is experiencing a modern rapid development in different stages. Except the policies, the efforts and contribution made by the people to improve the economy efficiently is appreciable. It is traditionally known factors that Chinese people work very hard and are very good at thinking in different ways of creating better environment for themselves and to the next generation. In ancient China, the overwhelming majority of the population living in the countryside and business world, these were not based on the modern science but traditional agricultural technology that based on the trial and error system by generations. The diligence, wisdom, determination of them created a lot of treasure for the whole country. Modern China, with the more-opened policies and new technologies and the dedicated Chinese people will ensure fast track development which will bring the country to number "one" position in the world.

**The reform and opening-up policy:** The Chinese economic reform refers to the program of economic reforms called "Socialism with Chinese characteristics" in the People's Republic of China that were started in December 1978 by reformists within the Communist led by Deng

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<sup>2</sup> Wikipedia. [http://en.wikipedia.org/wiki/Economy\\_of\\_the\\_People's\\_Republic\\_of\\_China](http://en.wikipedia.org/wiki/Economy_of_the_People's_Republic_of_China)

Xiaoping (Qin Fangshun, 1999). The goal of Chinese economic reform was to transform China's stagnant, impoverished planned economy into a market oriented economy capable of generating strong economic growth and increasing the well-being of Chinese citizens.

After the death of Mao Zedong in 1976, an alteration in the economic system was introduced. Just as abolishing the people's communes, readmittance of family-oriented agriculture, and limited introduction of prices and markets initially outlined China's economic course to supplement the planned economy by stimulating production via natural market regulation.

Economic reforms began in 1978 and occurred in two stages. The first stage, in the late 1970s and early 1980s, involved the collectivization of agriculture, the opening up of the country to foreign investment, and permission for entrepreneurs to start up businesses. However, most of industries remained state-owned, inefficient and acted as a drag on the economy. The second stage of reform, in the late 1980s and 1990s, involved the privatization and contracting out of much state-owned industry and the lifting of price controls, protectionist policies, and regulations, although state sectors such as banking and petroleum remained unchanged. From 1978 to 2010, unprecedented growth occurred, with the economy increasing by around 10% a year. China's economy became the second largest after the United States.

Results of reform and opening-up policies affected a shift of not only the economic, but also the justice and political systems. Export-oriented growth policy and the intended support of foreign investment brought with it the need for stability of the law. The Chinese government endeavored to reform economic law as well as the justice system both with the goal of better serving justice and with the idea of forming the law into a better tool. On a political level, reform led to a narrower integration of state officials and the economy, which also led to corruption. Corruption has become one of the most important concomitants in view of the economic shift. The success of China's economic reforms has also resulted in massive changes in Chinese society. Poverty was reduced and both wealth and wealth inequality increased. In the academic scene, scholars have debated the reason for the success of Chinese economic reforms.

**The change of economic performance under the reform:** China's economic growth since reform has been very rapid, exceeding the East Asian Tigers. Since the beginning of Deng Xiaoping's reforms, China's GDP has risen tenfold. The increase in total factor productivity (TFP) was the most important factor, with productivity accounting for 40.1% of the GDP increase. For the period 1978-2005, Chinese GDP per capita increased from 2.7% to 15.7% of US GDP per capita, and from 53.7% to 188.5% of Indian GDP per capita. Per capita incomes grew at 6.6% a year. Average wages raised six times between 1978 and 2005, while absolute poverty declined from 41% of the population to 5% from 1978 to 2001 (Wikipedia. [http://en.wikipedia.org/wiki/Economy\\_of\\_the\\_People's\\_Republic\\_of\\_China](http://en.wikipedia.org/wiki/Economy_of_the_People's_Republic_of_China)), Besides, China is widely seen as an engine of world and regional growth. China's trade deficit with the rest of East Asia helped to revive the economies of Japan and Southeast Asia. Asian leaders view China's economic growth as an "engine of growth for all Asia".

With the reform policy, more and more Chinese businessmen began to have the chance to cooperate with foreign investors. Since the reform started, foreign investment helped to greatly

increase quality, knowledge and standards, especially in heavy industry. China's experience supports the assertion that globalization greatly increases wealth for poor countries. Throughout the reform period, the government reduced tariffs and other trade barriers, with the overall tariff rate falling from 56% to 15%. By 2001, less than 40% of imports were subject to tariffs and only 9 percent of import was subject to licensing and import quotas. Even during the early reform era, protectionist policies were often circumvented by smuggling (Wikipedia. [http://en.wikipedia.org/wiki/Economy\\_of\\_the\\_People's\\_Republic\\_of\\_China](http://en.wikipedia.org/wiki/Economy_of_the_People's_Republic_of_China)). When China joined the WTO, it agreed to considerably harsher conditions than other developing countries. Trade has increased from under 10% of GDP to 64% of GDP over the same period. China is considered the most open large country. By 2005, China's average statutory tariff on industrial products was 8.9 percent. China's trade surplus is considered by some in the United States as threatening American jobs. In the 2000s, the Bush administration pursued protectionist policies such as tariffs and quotas to limit the import of Chinese goods (Wang Sisi, 2007).

During the economic reforming and opening-up strategy, the productivity played a significant role in Chinese economic growth. Chinese productivity increased at an annual rate of 3.9 percent during 1979-94, compared with 1.1 percent during 1953-78. By the early 1990s, productivity's share of output growth exceeded 50 percent, while the share contributed by capital formation fell below 33 percent. Analysis of the pre- and post-1978 periods indicates that the market-oriented reforms undertaken by China were critical in creating this productivity boom (Zuliu Hu and Mohsins Khan, 1997).

The economic reforming and opening-up policy also raised economic efficiency by introducing profit incentives to rural collective enterprises, family farms, small private businesses, and foreign investors and traders. It also gives greater room for the development of private economic sectors, which paid state taxes, create jobs, developed much-wanted consumer products, earned foreign currency through foreign trade, and gave the national economy a flexibility and resiliency that it did not have before.

### **Regional Development of China's Private Sector-Wenzhou Model**

*Wenzhou - Birthplace of China's private economy:* Wenzhou is a prefecture-level city in southeastern Zhejiang province. The area under its jurisdiction, which includes two satellite cities and six counties, had a population of 8,076,000 in 2009 (Zheng Xiuping, 2010). It borders Lishui to the west, Taizhou to the north, and looks out to the East China Sea on its eastern coast.

Wenzhou was a prosperous foreign trade port, which remains well-preserved today. It is situated in a mountainous region and, as a result, has been isolated for most of its history from the rest of the country, making the local culture and language very different from those of neighboring areas. It is also known for its emigrants who leave their native land for Europe and the United States, with a reputation for being enterprising natives who start restaurants, retail and wholesale businesses in their adopted countries.

In the early days of economic reforms, the people of Wenzhou took the lead role in developing a commodity economy, household industries and specialized markets. Many thousands of people and families were engaged in household manufacturing to develop individual and private economy. Until now, Wenzhou has a total of 240,000 individually-owned commercial and

industrial units and 130,000 private enterprises of which 180 are group companies, 4 among China's top 500 enterprises and 36 among national 500 top private enterprises (Wang Zhikai, 2009). The quantity, industrial output, tax, export and number of employees of the private enterprises account for 99%, 96%, 75%, 95% and 80% of the whole city respectively. There are 27 national production bases such as "China's Shoes Capital" and "China's Capital of Electrical Equipment", China's 40 famous trademarks and China's famous-brand products and 67 national inspection-exempt products in the city (Wang Zhikai, 2009). The development of private economy in Wenzhou has created the "Wenzhou Economic Model", which inspires the modernization drive in China.

**The contributions made by the Wenzhouese:** That Wenzhou was named as a national "model" which was based on a number of impressive facts. For example, the total product of society, the sum of the gross output value increased from 3 billion Yuan in 1980 to 13 billion Yuan in 1988. From 1978 to 1989, Wenzhou's industrial output rose from one to 8.9 billion Yuan. The most dramatic change occurred in the rural area where the proportion of the value of nonagricultural production in the total social product rose from 31.7% in 1980 to 67% in 1985. During the same period, the proportion of the labor force employed in nonfarm work in the rural area increased from 22% to 38%, and the average income of Wenzhou peasants, which before 1980 was among the lowest in the nation, was 50% above the national average in 1989 (Huang Jiajing, 1087). In 1990 Wenzhou established its own export processing zone, Longwan export industry zone and opened its first international airport, both constructed with local resources (China Daily, 1991).

According to the article written by Alan P. L. Liu, the key to Wenzhou's success may be summed up in one phrase: adapting traditional institutions to modern conditions. Specially, its formula may be described as a combination of "three Ms"-mass imitativeness, mobility, and markets-and "one I"-interstices (Alan P.L.Liu, 1992).

Rapid economic development in Wenzhou inevitably produced a host of social and economic consequences, with important local and national implications. Economically, the most tangible effect of Wenzhou's development was a reduction in the numbers of surplus labor. The household industries and the private businessmen made a huge contribution to the economic development and modernization in China.

**The vitality of Wenzhou model:** The vitality of Wenzhou model comes from Wenzhou natives. Without much dependence in state investments, the development of the city lies on the efforts of the native population. Vitality results from business culture, which is the top feature of Wenzhou's economy. Wenzhou businessmen have set their feet on the way of accumulating capital and also made themselves one of the important forces of the overseas Chinese businessmen. "Big market with small commodities, small money with high capital intensity" has become the prominent character of Wenzhou's economy.

Besides, vitality also originates from the opening up of the market. In recent years, Wenzhou has continuously deregulated to embrace foreign investment and has opened more widely to the outside world, encouraging the aspiring spirit of the local people in starting up businesses. From 1978 through 2009, the GDP of the city has increased from 1.32 billion RMB to 252.8 billion

RMB with the gross fiscal revenue increasing from 0.135 billion RMB to 36.1 billion RMB, and the net per capita income for rural residents increasing from 113.5 RMB to 10,100 RMB. The per capita disposable income for urban residents increased from 422.6 RMB in 1981 to 28,021 RMB in 2009, which is the third highest among Chinese cities, after Dongguan and Shenzhen (Wikipedia. <http://en.wikipedia.org/wiki/Wenzhou>).

### Conclusion

In China, there are many economic developing models in different regions, for example, Sunan model in Jiangsu province, the Yangtze River Delta and the “West bank of the channel” special economic zone in Fujian province. All those economic developing models and special economic zones born after the reforming and opening up policy will be playing a more and more important role in the future economic development. Those industries and companies, especially the private industries and companies located in those areas are creating huge treasure to China. They not only supply numbers of the opportunities for employment, but also tighten the friendship with different countries and make a significant contribution to the development of the international economy all over the world.

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