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A large, stylized red cursive number '2003' is centered within a thin purple rectangular border. The number is written in a fluid, calligraphic style with thick strokes and elegant curves.

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Foreword*

LiShi

With an assignment of being the executive editor-in-chief of *Economics in China*, 2003, honoured by Unirule Institute of Economics (UIE), I for one embarked on some kind of paper-searching expedition. As a brand-new mechanism was introduced, the venture this round seemed jolly breezier compared with its predecessors where one has to be nerry enough to relive. At the time, an editor-in-chief had to plod through all papers possible, pluck out the valuable, and then put them back together into a book. This time, however, all the chief had to do was to refine the papers extolled by the fellow young venturers trekking along on this still bumpy, but otherwise joyful journey.

Not surprisingly, a bumper collection of altogether 53 papers was reaped along the way, 17 of which have since been short-listed for the book. They are selected from various publications and economic magazines, such as *Economic Research Journal*, *China Economics Quarterly*, *World Economy*, *Paper Collection of World Economy*, *China Social Sciences*, *China Social Sciences Review*, and others. I herein acknowledge all the effort made by those who were providing the logistic support of

* 此前言由刘一豪小姐翻译,在此对她的辛勤劳动表示感谢。

selection for the ultimate success of the venture. A list of their names is attached to the end of this foreword.

Now, it is probably time for us to revisit the year of 2003 that this book has held so much for and over which the domestic economy was once again romping along in its long-lost sizzling mood. In fact, that state of the economy had kept almost everybody sanguine until coming to the end period of the year when the first sign of over-cossetting of the economy by the fiscal stimuli started looming. That aside, the fact that most of the chronicle ailments of the economy did not even seem to disappear along with such a rampant surge has made the sting of the sorrow for most domestic economists all the more galling. Time after time, they were blind-sided with the blunders in policy-making, even though all these problems have long been under their close watch.

Admittedly, it is the shabby researches that have indeed got so much to answer for. How to up a notch or two in the level of economic research thus becomes tellingly imperative. Some clues are sorely needed as some approaches must be found. And that has been the primary aim of the series of *Economics in China* ever since the first book was published in the early 90's of the last century, and as well it remains one of the foremost wishes in this edition.

As with the papers selected, three of them have to do with economic basics in that their findings could serve as essential elements, or simply starting points for other researches. These are *The Inspiration System Design to Avoid Collusion: Discriminatory Asymmetric Institution*, by Messrs Chen Zhijun and Qiu Jingyuan, *Marketization Index for China's Provinces* by Messrs Fan Gang, Wang Xiaoru, Zhang Liwen and Zhu Hengpeng, and *Recalculating the Capital of China and a Re-*

view of Li and Tang's Article by Messrs Zhang Jun and Zhang Yuan.

In the first paper with the principal and agent approach, Messrs Chen and Qiu have theoretically designed an incentive mechanism thereby to put a possible check on the likely collusion amongst agents. In the world where monitoring cost becomes exorbitantly high, as in the line of salesmanship, a risk-sharing mechanism is introduced. To arrive at the optimal risk-sharing, however, some kind of benchmark as to a possible achievement has to be established. Given the fact that not all such benchmarks can be forthcoming, especially under the circumstances of information asymmetry, a relative one whereby various outcomes can be compared amongst different agents has instead been put to use. Yet, such a mechanism would get into a deep trouble if the agents started to collude simply by following their endowed instincts.

Merely upping the ante for the agents would only give them more reason to stick together merrily. Messrs Chen and Qiu then provide a way out by introducing a mechanism that focuses on the other end of the incentive spectrum, namely the benefit side of the structure. In the world of bureaucracy where the research lies, two treatments are proposed: one is the promotion conducted on the discriminative basis rather than some sort of routine exercise of taking one's turn, and the other is the right of joining the rank of being in the know. By hiking the gains at the benefit end, as prescribed by Messrs Chen and Qiu with their little theoretical model, a principal would no longer have to lose any sleep over the stealthy play of his naughty agents.

The second paper, *Marketization Index for China's Provinces*, by Messrs Fan, Wang, Zhang and Zhu, is actually a report on an empirical study. Its selection has to do with its strong bearing on domestic eco-

conomic performance and policy-making at both macro-and-micro levels, and also its valuable contribution to other researches in the field.

As is known in any market-based economy, the micro-structure is a signal most important limiting factor that not just sets forth the ceiling of growth in the short run, but also caps up the speed of transmission in macro-policy exercises. The depth and the breadth of the transition will thus exert immeasurable impact on a wide swath of the regional economies covering such areas as the rate and quality of growth, income, investments, consumption, and so forth. In fact, the index produced by the report has exhibited significant correlation between the degree of the transition and the performance of the regional economies. And that in turn provides some invaluable guidance to the regional governments in their on-going structural reforms.

On research frontier, moreover, the report has come up with yet another important explanatory variable for the empirical studies of the field—the degree of market-based transition, which could also serve as a limiting factor in the growth. Clearly for a transitional regime, the index produced is no less significant than those indicators such as GDP, CPI, Gini coefficient, or others.

In the paper written by Zhang Jun and Zhang Yuan, they have re-estimated the trend of the growth of capital supply in the Chinese market in the long run. Estimating the Chinese capital supply is a tough task, moreover an analysing foundation demanding persistent work to lay. Its precision is crucial for empirically explaining the trend of China's long-term economic development and its contributory factors. Compared with the earlier research, Zhang Jun and Zhang Yuan have applied to a new perspective to carry out the estimation for the capital

supply in the early days after the Chinese liberation, which is to refer to the statistics of Shanghai city to modify the past estimate result. It is because that for that period, the industrial statistics and data of Shanghai is the most reliable and comprehensive.

From my perspective, the discussions about the key problems during the estimation process is more valuable for this paper, which make us realize how far the research of this field has gone, as well as what problems need to be solved. As mentioned in the paper, in the estimation for human capital, the differences in contribution among people with various educational levels have not been determined, as has not the differences caused by various educational levels in varying times and regions. Nor can the depreciation of human capital be quantified. All these problems lead to the over-or under-estimation of human capital, and demand solution by future research.

The new government has placed the three agriculture-related problems in the first place in policy making. In order to increase peasants' income, the measure of lowering taxes year by year is adopted. There are two layers of problems in the rural tax&fee reform, one is that peasants would shoulder heavier burden, the other is the income gap would be enlarged due to regressive taxation, which is very often overlooked. *Rural Taxation Reform of China: Studies in the Political Economics* made empirical analysis about the regressive taxation, and based on the analysis, they reflected on the government control and tax&fee problem.

The result of their empirical analysis shows that, the regressive nature of taxation is clearly demonstrated among different provinces, that is to say, the poorer the provinces, the higher the tax rate (tax/income), and the heavier the peasants' financial burden. At the mean-

time the regressive nature of rural tax&fee system emerges among different households in the same region. Contrary to our expectation, the tax&fee rate is higher for low-income households than high-income ones since rural tax&fee expense is more closely connected with land and agriculture, which results in peasants engaged in farming receive a lower income but have to undertake higher tax rate. The direct impact of the regressive rural tax&fee system is to enlarge the income discrepancy, which makes the already great variation even more alarming. Then, what is the fundamental cause of peasants' financial burden and the regressive taxation? The paper has made in-depth analysis in this aspect, and the author's view is worth paying attention to. Some judgements make sense, e. g. the fundamental reason for the unreasonable rural tax&fee system lies in too much control from the government on rural areas, agriculture and peasants.

Another paper on rural problems is *Saving Behavior in a Transition Economy: An Empirical Case Study of Rural China* written by Wan Guanghua, Shi Qinghua and Tang Shumei. There have been a lot of researches on the rural income development, income distribution, employment and migratory working, while few addresses the rural households' saving behaviour. From this perspective, the paper of Wan Guanghua etc, is a new approach to the analysis about rural problems. The income level of Chinese peasants is low, but even with the limited income, they cannot spend it all in consumption and must save for the future. What are the decisive elements for their saving behaviour? This is just the question the paper attempted to answer.

In addition, the paper did not simply introduce the foreign saving model to analyse the peasants' saving behaviour, which is worth prais-

ing for. Since the peasants' saving behaviour is profoundly influenced by Chinese regulation and culture, the paper might be able to give a more convincing analysis taking the special features of Chinese rural areas into consideration, especially the liquid constraint caused by the laggard development of rural finance. Compared with other industries, agriculture bears higher risk. Peasants must undertake the risk of greater fluctuation of income, besides the danger of natural disasters, disease and death. The current system of rural finance cannot eliminate risk for them, so peasants have to rely on their savings to prepare themselves for possible risk and uncertainty. This point was well proved by their empirical analysis. They have discovered that efficient loan could lower rural saving rate, in other words, it could enhance current consumption level. Furthermore, the macro-economics policy implication of this discovery is apparent: provision of more loans for peasants can contribute to ease the economic recession caused by insufficient consumption.

The third paper on rural problems is *Nutrition, Health and Productivity—Evidence from Poor Areas of Rural China* by Zhang Chewei. His ideas that malnutrition and poor health would directly affect labour productivity are easy to comprehend by instinct, but it is quite another matter to prove them by empirical analysis. In his paper, Zhang Chewei applied to a number of the latest economical quantitative analysing techniques, and based on the analysis of the households statistics of Chinese less developed regions, he has not only proved that nutrition and health have apparent positive effects on agricultural production, but also estimated the size of the effect in terms of quantity. According to his estimate, before reaching a certain standard, the calories that peas-

ants receive from food have positive correlation with their production level, in other words production level rises as the peasants receive more calories. Besides, the influence of disease on the plant industry is evident. If one labour cannot work because of disease, his family may harvest nothing from the plant industry. These research results deepen our knowledge about the development mechanism of peasants' income in the less developed rural areas, and improve our understanding about the cause of poverty.

As the reforms in other fields drive ahead, the problems in the Chinese financial system become more evident, and the demand for reforms in financial systems runs higher and higher. It is only during the last few years that the financial corruption issues caused by the current financial system have been open to analysis. In research in this aspect, Xie Ping and his colleagues lead the way. Their research papers on financial corruption, which are publicized lately, have attracted the attention of scholars both at home and abroad. With the advantage of their working positions, they have collected first-hand data and carried out research on the extent and range of financial corruption. Furthermore, they have made in-depth analysis about its systemic cause and the macro-economical ill influence it has exerted. Here we have included two articles of Xie Ping and Lu Lei, named *Financial Corruption in Transition: The Transaction Characteristics and Institutions*, and *The effects on Resource Allocation and Output: The Macroeconomic Costs of Financial Corruption*. These two articles are relevant, leading us to a more comprehensive understanding about the range, extent, cause and effect of the Chinese financial corruption.

In the modern development economics, corruption has become a

hot topic, since most economists have come to realize that the greatest barrier to the economic growth of developing countries is the government corruption and the abuse of power, as well as the corruption and low efficiency of public departments. However, the modern literature on corruption has been mostly in the form of theoretical discussions, with the design and argument of many game models included, but largely due to the difficulty to collect data about corruption, the basis of empirical research has been flimsy. From this viewpoint, the two articles written by Xie Ping and Lu Lei hold much academic value. The questionnaire survey of such a wide coverage is rare both in China and abroad, and their surveys have covered all kinds of credit institutions, from the People's Bank to the rural credit cooperatives, including enterprises, peasants and self-employers.

In the first article written by Xie Ping and Lu Lei, the authors have showed the first-hand data collected. Their statistics demonstrate that financial corruption has become a common phenomenon in the field of finance. They have also discovered, with bribe calculated as a part of the loan cost, the real interest rate borrowers acquired from government financial institutions gets close to the interest rate in the nongovernmental market, that is to say, the mismatch between the nominal interest rate in government financial institutions and the interest rate in nongovernmental market is in fact a rent, which goes to the pockets of those holding power in financial departments. Seeing from an outsider's perspective, it is only because of this extra benefit, that their consumption level can be much higher than their salary level, their income higher than others. The second article of Xie Ping and Lu lei has discussed about the loss in the macro-economy due to financial corruption. With

a few simple linear regression models, they have told us the following interesting conclusions: financial corruption obstructs capital formation. The higher the bribe expense to acquire a loan, the lower the formation rate of social capital. Besides, the greatest harm corruption does to the macro-economy is its twist of the operational rules in the financial market and the capital's price, which consequently brings about ill operation results in the macro-economy.

If the laggard reform of financial system is considered an important obstruction to the Chinese economic mechanism, the problems in the Chinese fiscal system are even more serious. The financial system has to face the depositors with a sense of market economy and expectation of market regulations, which makes their problems easier to detect. However, for the fiscal system, its distributions are inside the government, therefore the problems are internal and hard to find out for the outside scrutiny. In case there is not enough supervision, or the supervision is not strict, the non-standard fiscal operations are more likely to appear. In fact, the Chinese fiscal system is farther away from democratic fiscal system than the Chinese financial system is from the clean market. *Taking about the democratic public finance: an analysis framework based on literature review* written by Liu Yunlong and Tang Lifang brings up a model of democratic fiscal system, with which they illustrate the problems of the current one. Democratic fiscal system, as the term suggests, means that the fiscal revenue and expenditure is decided through a democratic process, and it has to accord with or be close to the public preference towards public products and services, for which local government is the most efficient to supply, therefore objectively speaking, the independent power of the fiscal system has to be ensured.

However, to test the efficiency of such grant, we have to see whether the fiscal system can supervise the local government's revenue and expenditure, and at the same time guarantee the local policies' coherence to the public preference towards public products and services. To be efficient, a democratic fiscal system with public participation is necessary. This is the key policy implication we draw from the paper of Liu Yunlong and Tang Lifang.

As the Chinese economy is becoming more and more open, its connection with the world economy gets closer and closer, so more domestic scholars are paying attention to the relationship between the Chinese and the world economy. In the paper *The Price Pass-Trough Effect across the National Border: An Example of China*, Sun Lijian, Li Anxin and Wu Gang employ the Chinese statistics to estimate the influence of the international price fluctuation on the domestic price level. The research on the international transmitting mechanism of price is a hot topic in international economics. This problem looks easy, but is actually rather complicated. Firstly, there are a variety of influential factors on the domestic price level, and the extent of varying factors' influence is different. Secondly, the transmitting mechanism of the international price to the domestic one is subject not only to the exchange rate mechanism, but also to the domestic price and the monetary policy.

The paper of Sun Lijian etc., is a high quality work with both theoretical and empirical analysis. Theoretically, for analysing the interaction between the monetary policy and the pricing mechanism of the imports and exports, the paper discussed the adaptiveness of the model in the new open macro-economy and considered it more convincing than the Taylor's Rule. For empirical analysis, the paper has tried to answer

two meaningful questions. First, how to identify the outcome of two different price transmissions, that is, the exchange rate and the international price fluctuation? Second, which factors influence the price transmission? What would be the effect of the government's monetary policy? Closely relevant to these two problems is the "argument" that China exports deflation, which is made to help nagging politicians to win the election in some developed countries. The authors of the paper applied to the statistics of China, the United States and Japan, and have made empirical answer to the previous two questions. They have also responded to the "argument" that China exports deflation.

One important development on research front in the domestic economics circle is the growing concern about the influence on the domestic market of the international economic situation, and rapid progress has been made in the research in this field. Different from the previous papers limited in descriptions, the three papers included in this book have strengthened the analysis of these problems. They are *An Empirical Study on the Twin Crises: Banking & Currency Crises* by Liu Liya and Ren Ruo'en, *Financial Structure and Economic Growth: Example of Manufacturing Industry* by Lin Yifu, Zhang Qi and Liu Mingxing, and *Opening China's Capital Account: Development of the Sequencing Theory* by Zhang Zhichao.

By effective construction of models and careful study about the statistics, which are of 32 newly-developed and 21 developed countries from 1975 to 2001, Liu Liya and Ren Ruo'en have discovered that the bank and the monetary crisis have their uniqueness as an individual event and the interrelationship as a coalition. An even more profound discovery is that for countries of different development levels, the inter-

relationship between the bank and the monetary crisis varies. Especially in some newly-developed countries, the possibility of the bank and the monetary crisis taking place together is greater than in developed countries. This is because that after these countries adopted the free financial policies, they did not effectively supervise the inflow and outflow of foreign capital, thus massive transactions of foreign capital were conducted before and after the bank crisis, which gradually developed into a monetary disaster.

The paper of Lin Yifu, Zhang Qi and Liu Mingxing tried to empirically analyse the relationship between financial and economic structure. Their basic judgement is that the financial system and the financing structure must match the economic framework. In order to provide proof, they came up with two relevant explanations. First, the bigger the industry's average scale, the greater density of banks, and vice versa; second, according to experience, the bigger the industry's average scale, the greater the demand for financial organizations offering direct investment. But in an economy dominated by medium and small enterprises, there is greater demand for financial organizations offering indirect financing. They have empirically proved the two hypotheses with statistics of 60 countries, and the result shows that in the field of manufacture, there is an apparent positive correlation between the productivity per person and the cross-product of the bank's density with the average scale of the plants. Their analysis also indicates that, in the manufacture industry, if we multiply the average scale of plants, with the ratio between exchange amount in the stock market and the bank's loans, which is used to indirectly reflect the financial structure, the product is a new variable also positively correlated to the rise in productivity per

person. This discovery provides evidence for the second hypothesis. The inspirations of these analytic results are obvious; how to design and arrange a rational financial mechanism and financial structure which match the economy is essential. We should avoid neglecting the current situation of the Chinese economic development and blindly introducing the financial structure in the developed countries.

The main content of the paper written by Zhang Zhichao is a summary of the Theory of Sequence employed in the foreign reform, and it suits both refined and popular tastes. As a theme in transitional economics, the Theory of Sequence in the reform process came into our view during the past decade or so. It is a theoretical reflection on the summarized lessons learned by countries in their economic transition. Such questions were once brought up in the early days of the Chinese reform in different forms, taking for example the discussions about whether the price reform should go first or the reform of price, taxation and finance should be carried out together. In simple words, which reform should be implemented first and which second in frontier of many fields demanding revision. Unfortunately, though the Chinese scholars brought up this question early, they did not carry out deeper research, not to mention enhancing it to a theoretical level. We herein include the paper of Zhang Zhichao. On one hand it can help us to learn more about the latest research development about the Theory of Sequence employed in foreign reforms, on the other hand it leads to our reflection about why the problems closely related to our economy development were not seized and theoretically explained by our own scholars, and now we have to introduce the foreign study results.

To use economic theories to explain the historical transition and