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Foreword

Zhang Shuguang

Acknowledgement

12 volumes(one volume per year) of the proceedings entitled "China Economy" has been published since 1994, and has been enjoying the fame both locally and internationally. As a historical record of the development of China's economic research, the proceedings have reflected the progress of the development of China's economic research for some extends. From the other aspect, the proceedings has become not only an absolutely necessity in the library at every economic universities and colleges, but also an essential reference materials for numerous of post students, thanks to the close collaboration between Shanghai Century Publishing Group and Beijing Unirule Economic Institute. Also, the success of the proceedings owes to the hard working by all editors involved, the great support from counterpart magazines and researchers in the field of economic research, as well as the joint efforts by the whole educational circles in China. I am very pleased, on behalf of all my colleagues, the editors and publisher of the proceedings to express my sincere thanks and appreciations for their contributions.

As the chairman of the editing committee of the proceed-

ings, I would like to take this opportunity to apologize to readers for the delayed release of the volume 2006 of the proceedings, which was due to the substitution of the executive editor.

Papers chosen in the proceedings

The 16 papers compiled in the volume of 2006 includes four from *Economic Research Journal*, four from *Quarterly Journal of Economics (China)*, three from the *Journal of World Economy*, two from the *China Journal of Economics*, and *China Social Science*, *Management World* and *Population Study* one each, thanks to the magazines/publications for their recommendation of and permission to reprint the papers. To this end, readers can realize that, not as the usual, papers in the proceedings were not chosen mostly from the “Economic Research Journal”, but also from other magazines/publications concerned thereby promoting the multiplicity and competition in the economic study.

Below is an overview of the 16 papers by the editor.

How to retain external and internal balance and the heavy appreciation pressure on RMB are two key focuses in China today, and has lead to great attention in the academic circle. Five papers were selected concerning issues of favorable balance in the current and capital account, international trade and exchange rate.

The paper of “China’s Twin Surplus: Nature, Roots and Policy Responses” built a theoretical framework using GDP accounting and balance of payment approach to analyze China’s twin surplus in the current and financial account. In the paper, the author analyzed the deposit and investment by inventorying

them into three categories, e. g. domestic private (e. g. individuals and enterprises), governmental and foreign ones. The core of the analysis was focused on the relationship of the gap between the private and governmental deposit and the investment and the foreign exchange reserve. Based on this analysis, the author revealed the relationship between the nature of the double surplus and the increasing accumulation of foreign exchange reserves in China. It was indicated in the paper that the surplus of current account shown clearly that foreign deposit in China was not used for investment, and foreign investment in China was originally from domestic deposit. What foreign business gained in China is capital equity, whilst what the U. S. bonds bought by China is of a type of creditor's right abroad. And the FDI increase and FER accumulation are the result of the trade mentioned above. Furthermore, the paper illustrated the twin surplus by analyzing various types and means of FDI inflow, and discussed the sustainability of the twin surplus thereafter. In addition, the paper also unveiled conditions for sustainable surplus in the current account, and recommended possible policy to lower the surplus. The mathematic models established in the paper were worthwhile and deducted clearly. It could be much better if verifications could be applied onto the sustainability of either the surplus or the current account.

The paper of "Vertical Specialization in China's Export and Sino-U. S. Trade" developed by CCER of Peking University was aimed at answering the following question: In China's increasing export volume, what proportion were actually imported intermediate and what proportion were actually added value belong to Chinese manufactory? The answer of this question can help us to make better informed decisions in dealing

with international trade conflict. Applying the definition and method on vertical specialization by Hummels et. al. (2001), the authors found that VS (vertical specialization) ratio in China's gross export volume has risen from 14% in 1992 to 21.8% in 2003. In addition to that, one third of increases in the overall VS ratio of Sino-U. S. trade were resulted from the import of semi-finished products from Japan and Korea by China. However, the inadequacy of this paper was that it used the 1992 Chinese export matrix to substitute that of 1993—1996 and the 1997 Chinese export matrix to substitute that of 1998—1999. It might be better if the authors used weighted means of the beginning and the end matrix to estimate the matrix data in between thereby making the result conform better to the actual status.

The paper entitled “The Consequences of Currency Appreciation: A Theoretical Model Based on Chinese Stylized Facts” was presented by Zhang Bin and He Fan from the Institute of World Economics and Politics, CASS. The paper examines internal and external impacts due to currency appreciation by linking the impacts with each other, and Based on a fact that, within the economical increase in China, the China's tradable sector enjoys a faster TFP growth than non-tradable sector and the relative price between tradable goods and non-tradable goods, the author developed a tradable-nontradable model. With the mode, it suggested that, under the scenario of relatively exogenous price, the two policy combination of fixed nominal exchange rate and low inflation target, the relative high growth of TFP in tradable sector bring about not only economic growth, but also: (1) distorted economic structure; (2) enlarging trade surplus; (3) wage depression and sl-

owdown of transferring labor force from rural area to urban area; (4) worsening of income distribution. Currency appreciation and faster TFP growth in nontradable sector is the key to solve above distortions.

China's recent rapid accumulation of international reserve and the succeeding appreciation pressure on RMB lead to great attentions on the actual exchange rate of RMB. "The NATREX of the Renminbi: 1978—2004" by Prof. Sun Maohui from Shanghai Normal University applies the NATREX approach to the study of the equilibrium real exchange rate of RMB. The NATREX model supposes there exist a real exchange rate that both ensure internal and external equilibrium. In the meantime, it only takes the medium and long term determinant trend into consideration while ignoring short term determinants like business cycle, international capital flow and foreign reserve change. The author found that, between 1993 and 1997, RMB was underestimated while after the year 1997 the real exchange rate of RMB approached to its equilibrium level. However, this paper considered only the appreciation pressure from financial aspect, i. e. the twin surplus in the current account and financial account and the interest rate difference between China and the U. S.. Since it didn't take into account the real economy, it paid attention on neither the fact that China's economy will endure a long catch up process in the upcoming decades nor the robustness of its findings and addressed deeply the related policy in detail.

Since the beginning of the "China Economic Annual", we have been focusing on compiling book and literature review into this proceeding. In this volume, we selected Prof. Lu Feng's review article "The Puzzle of Renminbi Real Exchange

Rate (1979—2005)”. The three main contributions of this article are: (1) On the basis of measurement of RMB’s real exchange rate since the late 1970s, it observes the distinct evolving pattern of RMB through international comparison with the performance of the real exchange rate of selected catch-up economies; (2) highlight Chinese economists’ work on this subject, the article not only affirm the “Zhou Xiaochuan-Xie Ping” hypothesis but also review and comment recent research by Chinese economists. Confirm their contribution and point out their limitation; (3) point out the merit and inadequacy of “Ballasa-Samuelson” effect in explaining the trend of the real exchange rate of RMB. The article then argued that in analyzing the real exchange rate of RMB, one should pay special attention to the fact that China is an economically transitional country. This paper was the first ever in a series of papers written by the author in analyzing RMB exchange rate, and also a must read for any one who is interested in this issue.

China has enjoyed a rapid economic growth in the past decades while the social conflict becoming more and more frequent. These social conflicts received especial attention in the academic circle. Here we present five papers involving in three subsequent categories.

The first paper was “Growth Imbalance and Government Responsibility: An Analysis from the Perspective of Social Expenditure”. This paper saw the imbalance between the economic size and Chinese people’s welfare as an intrinsic feather of China today. This was largely due to insufficient government spending on social expenditure. The paper proved that under certain conditions, an increase in the government expenditure on health, education, etc. can help the accumulation

of human capital for the whole society. And thus achieve sustainable and health economic development. Admittedly, increasing governmental public spending is one way to solve the growth imbalance; another equally important approach is for the government to deregulate the private sector.

The second category consisted of two papers on education. Among the two papers, the first one is "Demand for Education in China: 1991—2002" by Gregory C. Chow and Shen Yan. This paper offers an explanation of the quantitative changes in education spending by the framework of demand analysis. Income effect is estimated mainly by using cross-provincial data, while time series data are used to estimate the price effect. Changes in government and non-government spending through time can be satisfactorily explained by the factors of demand. Demand for education services in the three levels of primary school, secondary school and higher education and aggregate demand for education services are investigated. One of the most interesting finding of this paper is that the inequality in education opportunity was more serious than income inequality.

China has long been adopting a rationing policy in college admission that favors a few mega cities while discriminates against other regions of the country. Such discrimination has caused a series of social problems and arisen great concerns. Up to now, discussions on this issue focus mostly on social fairness, whilst the paper, entitled "Regional Discrimination in China's Higher Education, Endogenous Growth and Welfare Analysis" and written by Liu Yuming and Zhang Qinghua, focused on long-term influences of the regional discrimination from the economic aspect. In the paper, the authors studied

and analyzed influences of various quotas in college admission to the stable economic growth at each individual region based on an endogenous growth model(including the brain drain). In the meantime, influences to the welfare distribution were also analyzed in the paper. The result of the study showed that a proper partiality of quotas rationing to regions with rich educational resources will benefit the overall social welfare, but an over regional discrimination can lead to loses of social welfares. Of cause, there are some points in the paper that are needed to be addressed further. For example, the influences to the accumulation of human resources by the quotas were based on assumptions but not on the endogenous growth in the model. Besides, whether the stable-growth based welfare analysis model is adoptable to the developing status of China's economic is yet to be deliberated. However, it is of no doubt that the author brought a new start point for the study of regional discrimination in college admission in the higher education in China.

The third group of papers compiled covers studies on income distribution. Among the papers, one was by Luo Chuliang and entitled "Urban-Rural Divide, Employment and Subjective Well-being". The author analyzed in the paper the difference of subjective well-being between urban and rural residents by applying probit model on a basis of household surveys. It was unveiled in the paper that both the income and the increase rate of urban residents were much higher than that of the rural ones, whilst the subjective well-being of rural residents was much higher than that of urban residents due to the different level of expectancy related to self satisfaction, income level and living standard by them. In urban areas, the difference of subjective well-being between the jobless and employees relies

on the income effectiveness. The author has done a good job, and a thorough analysis could be done by separating immigrant workers out from the whole thereby further illuminating the limitation of the effectiveness of the absolute income and the relative income.

Another paper entitled "Which is the Main Reason for Income Inequality in Rural China: Physical Assets or Human Capital?" was by Gao Mengtao and Yao Yang. It was different from the original methods and cut-in aspect on the issue, the author didn't focus on the measurement of inequality and the analysis of income inequality, but on the analysis of the micro causes of farmers' income inequality. Also in the analysis, the author didn't use the commonly used earning equation and the parametric estimation method, but established a simplified quintile regression function with the method of non-parametric regression, to measure the impact of labor education (the measurement of the human capital) and fixed assets (the measurement of physical capital) onto the average income per rural capita. The result showed that, under a changing social environment, the human capital increased by education could raise the efficiency of getting access to and using information, and could get higher return than the increase of physical capital. This was the main reason for the increased income inequality between each household since 1980s. Shortages in the paper involve two points, one related to the continuity of the data used in the paper, if the data could be used as panel data. The illumination was not clear enough. The second point was that the objective of applying the quintile regression method was to realize the effectiveness of estimation factor. Besides, it seems that more study should be conducted to clarify whether the

dissimilitude quintile regression would be exactly the inequality of the regression of various groups of people on different income level.

The economical development of China can be directly linked to its population and employment, and therefore, it is obligatory for Chinese scholars to study on this issue along with the increase of the population in particular the senile people including such hot concerns as how large the population bonus is and when the Lewis turning point will come. This is a significant issue facing China's sustainability. Du Yang presented and discussed the issued in his paper entitled "Changes of Labor Demand and Supply and Labor Cost", and the paper brought great attention in the academia. On a basis of long-term population estimation, the author believed that China's population peak will come at 2030, earlier or later. He pointed out that the labor supply has marginally digressed since the early 2000, and the absolute digression will emerge within 10 years, whilst the trends of marginal digression of the elasticity of employment are yet appearing. In this connection, the author predicted that the Lewis reflection point related to China's labor supply will occur within the period from 2005—2010. By then, it will face problems of raising payment and increased labor costs. The short supply of labors and the soaring labor cost are a sign of it. To this point, the editor will not agree without giving serious thought, but would like to point out that the discussion on the elasticity of labor demand seems not enough, while the development of social system, technology and production is yet to be fully considered. However, the issued rose by the author was really significant and more attention should be paid by all of us.

Regarding issues of population, employment and economical growth, a paper entitled "An Analysis of Economic Convergence under Conditions of Large-scale Labor Migration" by Shen Kunrong and Tang Wenjian was compiled by the editor. In comparing with the paper by Du Yang on when the Lewis turning point will come from the aspect of the labor supply in China, the paper by Shen Kunrong and Tang Wenjian analyzed economic convergence under conditions of large scale labor migration. Based on the facts of the large scale labor migration in China, the author, based on the aspect of and exceeded Solow's new classic convergence mechanism, built a new model of convergence analysis framework and pointed out that the characteristics of economic convergence could rely on the scale of labor migration under a transition economical period and characterized by an inversed "U". In the meantime, demonstrations of China's actual data were also applied to verify the model. If the dynamically economical development was a fact in China, it would be no need for us to worry about the gap.

There are three papers in the category of industrial organization. They are on industrial agglomeration; the dynamics of TFP and innovation in the private business.

"FDI, Industrial specialization and Industrial Clusters" aimed to study the cause and mechanism of the spatial specialization and agglomeration of manufacturing sector in south-east China. The authors raised two hypothesis based on the theory of comparative advantage and new economic geography. The follow up empirical study showed these two hypotheses could explain part of the reality. Then the author build a theoretical model and proved that under the precondition of opening-up policy, FDI in the south east China had a spill over effect on

the rest of China.

Another paper in this category is “The Dynamics and Decomposition of the Aggregate Productivity in the Zhongguancun Science Park: 1995—2003” by Zhou Li-an, Zhang Wei-ying, Gu Quanlin, Jiang Ye. This paper analyzes the dynamics of aggregate productivity in the manufacturing sector of Zhongguancun Science Park through decomposition of labor productivity and total factor productivity based on firm level data. They found that the sources of productivity changes mainly consist of learning effect, i. e. , existing firm achieving growth through learning-by-doing, and selection effect, i. e. , the dynamic process of firm entry and exit.

The third paper entitled “Firm Size, Market Power and the R&D Behavior of Non-government Enterprises” was presented by Zhu Huanpeng. Ever since Joseph Alois Schumpeter expressed his viewpoint, i. e. market drivenness and business size play a crucial factor to the innovation of an enterprise, the theory and practices concerning innovative activities of enterprises have been studying incessantly and resulting in disparate findings and conclusions. Lots of locally published papers are available in this regards. However, only a few studies were conducted focusing on innovations by private owned enterprises. By taking expenditures of R & D as the indicator of enterprise's innovation, the gross assets and the income of industrial trade as the indicator of the enterprise size, the main product price and its comparison with that of its competitors as the indicator to reflect the market share(or market power) of an enterprise, plus considering factors of capital intensity, business performance and geographic location differences between enterprises, it was concluded in the paper a reversed

“U” type relationship between the size and market power of an enterprise and its R&D strength. Moreover, the paper further analyzed enterprise innovation models from aspects of the size, market power, competition measures and business characteristics, etc. However, there seems some inconsistency between the facts quoted and the conclusion derived, e. g. the increasing proportion of adopting the model of independent innovation and the model of independent innovation with a certain level of market power by small-sized enterprises. To this point, further illumination is necessary.

The last paper entitled “Dual-Operational Objectives of SOEs and TFP Accounting Micro foundation” was written by Wang Xi, Shu Yuan and Cai Guowei. The paper examines the application of TFP accounting method in China and amended the results derived. Originated from the new-classical economic growth theory, the traditional TFP accounting method assumes all production factors are displaceable one another, whilst all diminishing marginal physical product factor, factor growth rate and the growth rate of technical development are exogenous. The two calculating methods applied include “regress method” and “shift-share method”. Due to its inherent shortage, the regress method was no longer used by some researchers, whilst the two main assumptions, i. e. “a producer is a factor-price taker and seeks maximum profit”, are not consistent with the actual conditions in China. Most former studies focused only on figure quality and the form of production functions, but paid little on systematical errors within the TFP accounting due to differences of the micro-foundations. The author amended the adopted micro-foundation on a basis of the dual operational objective of state-owned enterprises, and re-

estimated the TFP value based on the actual conditions in China. The most inspiration by the paper was that a proper analysis and its result can only be achieved by focusing closely on the fundamental characteristics of China.

In the foreword (Chinese version) of this book, Prof. Zhang also reviewed the development of China's economic research ever since the reform and opening-up. However, due to limited space available, we don't present the full English translation of this part. Below are the titles of each chapters in this part:

1. Economics in China in the past century.
2. The dispute on economic man.
3. The development in the theory of the firm.
4. Institution evolvement.
5. The Needham puzzle.
6. Research in macroeconomic theory.
7. Study on recession.
8. RMB exchange rate.
9. Advance in the study of income distribution.
10. Academic morality.