

CHINESE ECONOMY IN DISEQUILIBRIUM

非均衡的中国经济



Li Yining



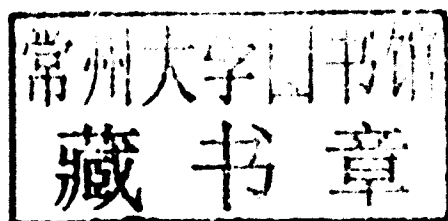


CHINESE ECONOMY IN DISEQUILIBRIUM

非均衡的中国经济

Li Yining

Translated by Chen Shulang



外语教学与研究出版社
FOREIGN LANGUAGE TEACHING AND RESEARCH PRESS

北京 BEIJING

图书在版编目 (CIP) 数据

非均衡的中国经济 = Chinese economy in disequilibrium ; 英文 / 厉以宁著 ;
(美) 陈菽浪译. — 北京 : 外语教学与研究出版社, 2013.11
ISBN 978-7-5135-3751-3

I. ①非… II. ①厉… ②陈… III. ①中国经济—研究—英文 IV. ①F12

中国版本图书馆 CIP 数据核字 (2013) 第 264174 号

出版人 蔡剑峰
策划编辑 吴 浩
责任编辑 赵雅茹
执行编辑 胡玉岩
装帧设计 蔡 曼 吕 茜
出版发行 外语教学与研究出版社
社 址 北京市西三环北路 19 号 (100089)
网 址 <http://www.fltrp.com>
印 刷 紫恒印装有限公司
开 本 730×980 1/16
印 张 19
版 次 2013 年 11 月第 1 版 2013 年 11 月第 1 次印刷
书 号 ISBN 978-7-5135-3751-3
定 价 66.00 元

购书咨询: (010)88819929 电子邮箱: club@fltrp.com
如有印刷、装订质量问题, 请与出版社联系
联系电话: (010)61207896 电子邮箱: zhijian@fltrp.com
制售盗版必究 举报查实奖励
版权保护举报电话: (010)88817519
物料号: 237510001

Preface

The Chinese language edition of *Chinese Economy in Disequilibrium* was first published in 1990, but the manuscript was finished toward the end of 1988. To explain why I wanted to write such a book at that time, I must start from the conditions of the development of the Chinese economic reform in the 1980s.

The Chinese economic reform started from the introduction of the Agricultural Contract System in 1979. Farmers in Anhui, Sichuan, and some other provinces spontaneously divided their lands and fixed farm output quotas on a household basis. This innovation greatly motivated farmers and boosted output. The central government closely monitored this change, sent out investigation teams to Anhui and Sichuan to learn from the farmers' experience, and eventually decided to promulgate their practice of the Agricultural Contract System to the whole country. This is deemed "the first spring thunder" of the Chinese economic reform. A few years later, farmers' markets flourished and the phenomenon of food shortage gradually disappeared. Another few years later, the urban food rationing system, which had been there for many years, was also abolished.

And then came the rise of township and village enterprises. These enterprises relied on funds raised by farmers: they needed no government investment and their products did not rely on government allocation. Consequently, the 1980s witnessed a unique phenomenon: Sales persons of these township and village enterprises traveled everywhere around the country, carrying samples of their products and seeking markets for them. The monopoly of planned economy was broken: a product market for township and village enterprise products emerged beside the planned economic system.

At the same time, a special economic zone was established in 1980 in Shenzhen of Guangdong, an area close to Hong Kong. There, resources were allocated by the market mechanism and economic growth accelerated in such

speed known as “Shenzhen Speed.” There is one thing people learned from this experience: The market mechanism in China is not only viable but also necessary.

The promulgation of the Agricultural Contract System, the rise of township and village enterprises, and the establishment of special economic zones were like 3 stones thrown into water that stirred waves—the Chinese economy was no longer a pool of quiet water. In the mid-1980s, the focus of the Chinese economic reform turned to cities. Concerning the questions of how to reform the urban system, and how to gradually transit from planned economy to market economy, Chinese economists saw a dispute between two ideas about the reform.

The dominant idea at that moment suggested “price decontrol” as the major route of reforms. Proponents of this idea believed that the experience of West Germany was applicable in China. They asked: West Germany did this, why can’t China? Their opinion received attention from the central government. In 1988, the State Council decided to implement a reform scheme that was centered on price reform.

At this critical moment, in late April 1986, I gave a long speech at Peking University on the topic of “principal ideas of reform,” where I pointed out that the Chinese economic reform should not be centered on price reform. Rather, it should be on ownership reform. I also pointed out in this speech that if the Chinese economic reform fails, it might be because of failures of the price reform. But the success of the Chinese economic reform must depend on ownership reform, that is, the success of enterprise reform.

This speech caught the attention of both domestic and foreign media. The Chinese State Council also took my advice seriously and postponed the announcing of the price reform scheme.

To get my ideas across to more people who are concerned of the Chinese economic reform, starting from that moment, I began to write this book in front of you, *Chinese Economy in Disequilibrium*. After 3 years’ work and rounds of revisions, the manuscript was eventually submitted to the publisher at the end of 1988 and the book was officially published in 1990.

Such is the background of the writing and publishing of this book. 1988 was a critical year, because it was in this year that the Chinese government

returned to the price reform scheme and was preparing to copy the “shock therapy” of West Germany, hoping to smooth the institutional transformation by way of price reform. I did not agree with this policy because in China under the planned economy regime, enterprises are not truly market players, instead, they are more like government affiliations. Thus, price stimulation could neither help sort out winner and loser enterprises in the market nor promote industrial restructuring. Thus, in China, the most suitable route for the reform could only be ownership reform and letting enterprises become genuine market players. My book *Chinese Economy in Disequilibrium* was written to clarify this principal logic for the Chinese economic reform.

Reforming practice in the 1980s and the 1990s proved my assessment of the conditions. As expected, a surge of panic purchasing out of peoples’ expectation of price rise forced the 1988 price reform to a halt. In the 1990s, China gradually transformed state-owned enterprises into shareholding corporations, and thus eventually led the Chinese economic reform out of its dilemma.

Now at the time when the English edition of *Chinese Economy in Disequilibrium* is about to be published, I recall the conditions and history of the Chinese economic reform at the time when I started this book and write this preface specifically for the reference of my readers of the English edition.

I express my sincere gratitude to Mr. Chen Shulang, who did an excellent job in translating this book from Chinese into English; Professor Cai Hongbin, Professor Zhou Li’an, and Dr. Yan Se from the Guanghua School of Management, Peking University; and Professor Laixiang Sun from the University of London, UK; Mr. Cai Jianfeng, Mr. Xu Jianzhong, Mr. Wu Hao, Ms. Deng Xiaojing, Ms. Yi Lu, Ms. Zhao Yaru, and Ms. Hu Yuyan from Foreign Language Teaching and Research Press; Dr. Niels Peter Thomas, Ms. Leana Li and Mr. Toby Chai from Springer Science and Business Media. This book would not be with you so quickly without their generous help.

Li Yining

Beijing, People’s Republic of China

September 21, 2012

Foreword

“Among all your publications on current Chinese economy, which one is most representative of your academic viewpoints?” If this is the question someone asks me, “it is the book right in front of us, *Chinese Economy in Disequilibrium*,” I would answer. Why do I have this answer? I have my own reasons.

Among my publications, *Institutions, Goals and People—Challenges to Economics* (Heilongjiang People’s Press, 1986) studied comparative economics. Many of its chapters discussed Chinese economic issues. It also proposed a methodology for studying socialist economic theories. Nevertheless, it is not a book on current Chinese economy.

Socialist Political Economics (The Commercial Press, 1986) is a textbook which described the framework of my economic theories, but barely discussed real economic issues. Moreover, it is a book on socialist political economy intended for beginners. Therefore, it is unlikely to include in-depth discussions and analyses of certain economic theories. Nonetheless, I believe it is the most comprehensive and systematic publication on my own economic theories.

Exploring Reforms of Economic Institutions (The People’s Daily Press, 1987) specifically discussed issues associated with the shareholding system, controlling shareholder system and conglomerates in the public ownership system. It did not further discuss any other issues.

Management of National Economy (Hebei People’s Press, 1988) is also a textbook, primarily discussing the principles and policies for managing the national economy from short-term, mid-term, and long-term perspectives. Due to the requirements of a textbook, it is difficult to fully discuss in-depth issues related to economic disequilibrium.

Perspectives on Chinese Economic Reforms (China Prospect Press, 1989) summarized the general economic reform plan that I proposed for China,

including the main reform directions and corresponding reform measures and execution processes. But it is not a book on disequilibrium.

Where is Chinese Economy Heading (The Commercial Press, Hong Kong, 1989) is a collection of my speeches delivered in Hong Kong at the beginning of 1989. It is intended to address a few specific issues encountered during Chinese economic reforms. Such topics as how to switch from the subcontracting system to the shareholding system, why it is not possible to privatize large and medium state-owned enterprises, and how to manage state assets were elaborated fairly thoroughly in the book. But it did not give a systematic analysis of the disequilibrium conditions prevalent in the Chinese economy.

Compared with the abovementioned publications, *Chinese Economy in Disequilibrium* is different in three aspects: First of all, it is academic research, not a textbook for college students. Although my analysis herein is based on the principles stated in the books of *Socialist Political Economics* and *Management of National Economy*, the theoretical study on economic disequilibrium is far more detailed than that in those two books. Secondly, it focuses on current Chinese economy, unlike the book of *Institutions, Goals and People—Challenges to Economics*, which focused on comparative economics. Thirdly, it features theories, primarily analyzing the characteristics of economic disequilibrium in an attempt to discover the underlying reasons for resource misallocation, distorted industrial structures, and institutional innovation variation. The book does not designate economic disequilibrium as a prerequisite, as did the books of *Exploring Reforms of Economic Institutions*, *Perspectives on Chinese Economic Reforms*, and *Where is Chinese Economy Heading*, but directly discusses specific policies for Chinese economic reforms. With these thoughts, I believe *Chinese Economy in Disequilibrium* is the book that most fully presents my academic views on current Chinese economy.

In my opinion, the book provides featured analyses in the following eight aspects:

1. There are two types of economic disequilibrium. Type I disequilibrium refers to the disequilibrium condition under which the market has not been fully developed. Type II disequilibrium refers to the disequilibrium condition under which the market is not fully developed and enterprises

lack profit maximization mechanisms and budget constraints. Current Chinese economy belongs to type II disequilibrium. We should do our utmost to first and foremost transit the economy from type II disequilibrium to type I disequilibrium, followed by gradually shrinking the magnitude of imbalance inherent under type I economic disequilibrium condition.

2. The socialist economy is susceptible to stagflation in economic disequilibrium. There are two types of inflation, open inflation and hidden inflation, with the latter referring to an unchanging price level at which commodities are actually out of stock. There are open and hidden stagnation as well, with the latter referring to the situation of superficial growth in aggregate output with effective supply actually remaining unchanged. Therefore, stagflation has four potential forms of combinations. Any measure to prevent and tackle stagflation must be properly adopted according to the specific situation.
3. The impact of structural factors on current economic imbalances in China cannot be ignored. Difficulties in industrial restructuring are associated with the defects of enterprise operation mechanism, and the shortsightedness of corporate behavior as well as societal behavior. Therefore, the rationalization of industrial structure can only be achieved by accelerating the reconstruction of enterprise operation mechanism and by actively leveraging the leadership of the central government in quota adjustment in the commodity market and the establishment of order in the socialist commodity economy.
4. Economic fluctuations are common in a disequilibrium economy. People tend to ask when an economy will come out of recession. It should be noted that it is relatively easy to pull the economy out of recession that is calculated based on the growth rate of output, for direct government spending or corporate spending with credit support will generate higher output growth. Nevertheless, it is far more difficult for the economy to come out of recession calculated based on the growth rate of enterprise profitability or the growth rate of actual fiscal revenues (i.e., excluding borrowings and net of inflation rate). We need to reform the enterprise operation mechanism, which is critical to actually pulling the national

economy out of recession.

5. There are various rigidities under economic disequilibrium conditions. In addition to many known rigidities, such as wage rigidity, employment rigidity, and welfare rigidity, there is a unique type of rigidity under current disequilibrium conditions (type II disequilibrium) in the Chinese economy, one called “enterprise rigidity.” It refers to the situation in which an enterprise is not actually responsible for its own profits and losses or only responsible when it is profitable. Thus bankruptcy is almost out of the question. Without resolving the “enterprise rigidity,” China will have to remain in type II economic disequilibrium for a long time.
6. If commodity shortages are prevalent, a dual-track price mechanism applicable to shortage commodities cannot be terminated if there are relatively severe resource constraints. Otherwise, even when the gap between the dual prices, i.e., planned and non-planned price, is eliminated, a gap between two new prices, i.e., open price and underground price, will appear. Therefore, a full price decontrol before all other conditions are ready will only lead to social turmoil and unjustified profits taken by certain people who can take advantage of the gap between open price and underground price.
7. Scarcity of certain resources, as well as the exclusivity stemming from such scarcity, may persist for a long time in the socialist commodity economy. The government has to make necessary adjustments, such as levying resource taxes on the producers of exclusive scarce resources. The government, however, should also be careful not to completely seize everything above normal profits, but only a portion. Otherwise, it won’t help improve resource utilization efficiency.
8. It is essential to further push economic reforms under current economic disequilibrium conditions. We are often confronted with this challenge: A new institution or policy tends to deviate from its original plan (hereinafter referred to as “institutional variation”). This is mainly attributable to such issues as non-standardized institutional innovation, changes in enterprise expectations and personal expectations, and market imperfection. Institutional variation can only be addressed by making appropriate adjustments in these areas.

Contents

Preface	i
Foreword	v
Chapter 1 Exploring the Issues in Resource Allocation	1
1.1 Resource Allocation in the Socialist Economy: From the Perspective of Disequilibrium	2
1.2 Resource Misallocation and Potential Stagflation in the Socialist Economy	10
Chapter 2 Market Regulation and Resource Allocation	23
2.1 Market Selection and Market Guidance	24
2.2 Investment Principal, Investment Behavior, and Resource Allocation	29
2.3 Consumption Principal, Consumption Behavior, and Resource Allocation	35
2.4 Market Self-Regulation During Resource Allocation	39
Chapter 3 Government Regulation and Resource Allocation	53
3.1 The Meaning of Government Regulation	54
3.2 Nonidealized Government Behavior and Its Impact on Resource Allocation	59
3.3 The Appropriateness and Optimization of Government Behavior During Resource Allocation	71
Chapter 4 The Mechanism of the Operation of the Economy	85
4.1 Dual Mechanism of the Operation of the Economy	86
4.2 Frictions in the Operation of the Economy	99
Chapter 5 Rationing Equilibrium of the Commodity Market	105
5.1 Commodity Market Equilibrium with Quantity–Price Adjustment	106

5.2 Applying Quantity–Price Adjustment Measures in the Commodity Market	117
Chapter 6 Easing Supply and Demand Mismatch Under Economic Disequilibrium Conditions	141
6.1 The Counter Effects of Government Price Adjustment	142
6.2 Reforming the Enterprise Operation Mechanism	153
Chapter 7 Industrial Restructuring	165
7.1 Domestic Source of Funding for Industrial Restructuring	166
7.2 Industrial Restructuring and Long-Term Orientation of Corporate Behavior	178
7.3 Industrial Restructuring and Unbalanced Economic Growth	194
Chapter 8 Government Regulation of Agriculture	209
8.1 Demand and Supply of Agricultural Products Under Disequilibrium Conditions	210
8.2 Trend of Balanced Demand and Supply of Agricultural Products	217
Chapter 9 Establishing the Order of the Socialist Commodity Economy	225
9.1 Establishing the Order of the Socialist Commodity Economy: Necessity and Difficulty	226
9.2 Interest Adjustment During the Process of Establishing the Order of the Commodity Economy	236
Chapter 10 The Standardization of Institutional Innovation	255
10.1 The Role of the Government in Standardizing Institutional Innovation	256
10.2 The Standardization of Institutional Variation and Institutional Innovation	268
Glossary	285

Chapter 1

Exploring the Issues in Resource Allocation

1.1 Resource Allocation in the Socialist Economy: From the Perspective of Disequilibrium

1.1.1 Disequilibrium Defined

In economics, disequilibrium is defined relative to Walrasian equilibrium, which is achieved under the assumption of a fully developed market and a flexible price mechanism. Disequilibrium refers to a balance condition under which there is neither a fully developed market nor a flexible price mechanism. In this sense, disequilibrium is also called non-Walrasian equilibrium.

According to the Walrasian theory, given that the market is fully developed and the price mechanism flexible, given also that every market participant possesses perfect information about current and future prices as well as a full understanding of current and future demand and supply, and that prices adjust instantaneously with changes in demand and supply, then, at any price level, aggregate demand is always equal to aggregate supply, and there is no excess demand or excess supply. All transactions are settled at equilibrium prices. If the equilibrium price is not reached, a transaction will not be concluded. Only when price is in equilibrium can a transaction be concluded. According to this theory, excess production, sluggish merchandise sales, chronic unemployment, and inflation due to excess demand will not occur.

The impractical Walrasian equilibrium has long drawn harsh criticism from some dissenting Western economists. Keynes discussed the issue of chronic unemployment in capitalist society in his book titled *The General Theory of Employment, Interest and Money* published in 1936. Until the early 1960s, however, research on disequilibrium by economists remained limited and sporadic. Even their interpretations of the Keynesian economic theory were drastically divided. Orthodox Keynesian economists believed that Keynesian economic theory belonged to the economics of equilibrium and that Keynes himself did not deny Walrasian equilibrium but simply made some modifications. Other Keynesian economists, however, believed

that the Keynesian theory had gone beyond the limit of equilibrium theory by providing an initial and systemic review on disequilibrium theory, as was demonstrated by Keynes' belief that the market mechanism was not always fully effective in coordinating various transactions and that production, employment, and investment would fluctuate, often leading to overproduction, unemployment, and insufficient demand for investment in capitalist society.

Since the late 1960s, the disequilibrium theory has made noticeable progress. Studies on disequilibrium have demonstrated that when a market is not fully developed and prices fail to function and adjust supply and demand, every economic factor will work its way to a point where they are mutually adaptable according to their respective situations to reach equilibrium. Obviously, the equilibrium under disequilibrium conditions is not one in a fully developed market, but one in a market that is not fully developed. It is not an equilibrium accompanied by zero unemployment or inflation rate, but one with certain unemployment rate and inflation rate. In other words, disequilibrium is actually a type of equilibrium, but unlike the equilibrium described in the Walrasian theory, it is real in daily life. This is the definition of disequilibrium in economics.

1.1.2 Resource Allocation Defined

Resource allocation refers to the allocation of various economic resources, i.e., labor, materials, and capital according to different uses. When resource supplies are limited, it is necessary to work out an efficient way to allocate various economic resources to meet various needs in order to maximize the output of products and services in demand. Any society, including socialist society, can only be considered to have achieved effective resource allocation when every person's talent has been fully employed, every product's utility has been maximized, and every inch of land has been fully utilized. If there are labor, materials, and capital left idle or wasted, the allocation of resources is considered problematic. One of the most important issues that economists study is how to achieve effective allocation

of resources in order to fully utilize existing resources and discover potential resources.

Resource allocation can be viewed in two different tiers. The higher tier refers to the allocation of resources among various sectors, regions, and production units. Whether the allocation is effective or not depends on whether each resource is effectively allocated to its best place. The lower tier refers to the organization and utilization of pre-allocated resources by a production unit, a region, or a sector. The effectiveness of the allocation depends on whether or not these resources are utilized to their fullest potential.

These two tiers of resource allocation have certain connections as well as differences. From the perspective of overall society, allocations of existing resources in different areas undoubtedly impact resource utilization efficiency at each economic unit as the total quantity of existing resources is limited, and ineffective resource allocation in the macroeconomy will certainly lead to low utilization efficiency at some production units. On the other hand, if most production units are able to raise resource utilization efficiency to a higher level, the supply of resources in the economy will increase. Compared with unchanged quantity of resources, higher supply of resources is more favorable to adjusting resource allocation in various areas and more conducive to allocating resources effectively. This is the connection between the two tiers of resource allocation. Their differences, however, are represented by different goals and ways of execution. The goal of the lower tier resource allocation is to raise resource utilization efficiency at a production unit so as to increase total output with fixed amount of input, while that of the higher tier resource allocation is to effectively put every resource to its best use and allow factors of production to regroup to maximize their utility. The two tiers of resource allocation also vary in terms of way of execution, with the lower tier increasing resource utilization efficiency by using production or managerial techniques inside the production unit without transferring production factors. The higher tier resource allocation achieves its goal via rearranging the combination of production factors, regulating property rights, transferring fixed assets,

making macroeconomic adjustments, as well as reforming macroeconomic management system.

Realizing effective resource allocation, either at the higher tier or at the lower tier, requires a long process. There is no absolute standard for effective resource allocation, nor is there a limit for how effective resource allocation can be. We can only say that whether resource allocation of this tier or that tier is more effective after certain adjustments or reforms, whether there is some improvement, or how much of an improvement. One of the important topics in the socialist political economics is to study how to manage the economy so as to improve resource allocation and increase effectiveness in the socialist economy, which will lead to higher effectiveness of both the higher tier and the lower tier resource allocation.

1.1.3 The Features of Socialist Economic System and Resource Allocation

Before studying resource allocation in the socialist economy, we must understand the socialist economic system as well as its impact on resource allocation. As various socialist economic systems can be categorized into several forms, resource allocation in the socialist economy can also be grouped accordingly. Each form of resource allocation has its own features associated with its economic system.

There are three types of economic systems categorized based on Chinese economic realities. The first type is the traditional economic system. The second type is the dual-track economic system whereby the traditional economic system is gradually giving in to the new economic system. The third type is the new economic system. The economic system from the late 1950s to the late 1970s was the traditional economic system, while that since the 1980s is the dual-track economic system, which we are currently under. The new economic system is the system we are aiming to establish through economic reform after breaking away from the dual-track economic system. It is still an economic system under planning and has not yet become reality.

The features of resource allocation under these three economic systems are as follows: