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Foreword: Modern Development of Economics in China

Zhang Shu—guang

China Economics—— 1994 is an anthology of economics papers, compiled by Beijing Unirule Institute of Economics, aiming at profiling the footprints of modernization of economics in China.

1. Background: Modernize Economics in China

The modernization of economics in China comes from the need and reflects the scope of modernization of China's economy. As a big country with ancient traditional culture and material basis formed during 40 years' planned economy, China has been in the process of tremendous transition, both institutional and social. China's modernization must have been abiding by the general rules of modernization, yet it possesses its own peculiarities. It is really a miracle that a big country with 1.2 billion of population has been sustaining a 10% annual economical growth for more than 10 successive years. China

has pioneered the “gradualism” road of reform, treading out of planned economy towards market economy, achieving an efficient combination of reform, development and stability. China has made her preliminary success, at the same time has been encountering her problems and difficulties. All of these call for scientific explanations and correct propositions of Chinese economists, thus forming the background where China has been modernizing her theoretic economic research.

Chinese economists, plunging into the surging tide of reform and development, experience both fortunes and misfortunes. Most of them have been educated and trained according to traditional economic theoretic framework, i. e., the traditional socialist political economics. The theory and methodology of traditional economics, formerly embodying centralized planned economy, have proved incapable of coping with any realistic problem arising in the current transition toward market economy. Naturally Chinese economists have to seek for new theoretic framework⁴ and research following new reality.

Development of China’s modern economics took as its beginning step the introduction and study of modern economics of the outside world. The theory of neoclassical economics came in first of all, followed by various non-mainstream theories. Chinese economists have absorbed abundant knowledge and implications from these theories, and are able to march onward, standing on the shoulders of great predecessors. Significant changes have taken place in their research work. Economic reasoning and analysis have been based upon the funda-

mental assumption of rational behavior (or maximization behavior) of all individuals taking part in economic activities. Methodology has been restructured; more emphasis being put upon individualism, cost-benefit analysis of various individuals or groups, empirical analysis and case studies during transition, dynamic analysis, institutional analysis, etc. Chinese economists have also helped establish a more normalized and freeminded style of academic activities.

2. Contents: 1994 Review

In 1994, major achievements of China economics focus on study of the theory of institution and institutional change, or transitional economics. Valuable theses have appeared in this field, and an anthology termed *Transitional Economics of China* has been published. It reflects a close linkage to China's reality.

China is pushing her process of transition from planned economy to market economy. The transition is neither a spontaneous nor a compelled motion, it is a process naturally breeding as well as launched by government. The government had established a planned economy in the past, now it wants to reform the economy. In establishing market economy, the government takes the initiative, yet it has to be reformed itself. Hence, the major problems in which transitional economics is interested embrace government choice of behavior and relationship between the government and various social sectors.

2.1 Property right is the basic structure of market economy and economic growth. On one hand, property right relies on state protection, on the other hand, impairment of property right by the state is the usual case. During the transition period, it is crucial to investigate how state power intervenes into property right arrangements, and how to establish an efficient property right structure.

Generally speaking, there are three kinds of mode concerning intervention of state power into property right arrangements. The first kind is one in which the state compels by force the acquisition or change of property rights, property right acquired by one body being the property right deprived of the other. The formation of property rights during establishment of planned economy belongs to this mode mostly. In the second mode, property right arrangement is utterly a contract between private persons, the role of state power being merely to confirm the validity and legitimacy of the arrangement, and to protect property right transaction according to the contract. In the third, the state intervenes into property right transactions. The state may act as buyer or seller, or, in case of transaction between private persons, the state may put a limit to the price, or limit to both price and amount of the transaction.

In reality, what kind of mode of intervention the state might take could not be chosen arbitrarily; it would be determined not only by basic institutional structure and its trend of change, but also by comparative abilities and potentialities of

the state and other social sectors. In the present economic transition, the intervention of state power into property right arrangements could no longer take the mode once adopted during establishment of planned economy, but resort to the second or third kind of mode. Numerous papers have been focusing on this investigation, among which, the papers by Zhou Qi-ren titled "Rural reform in China: Change of relations between state and ownership" attained the highlight, furthering the theory of institutional change pioneered by prof. Douglass C. North etc. . North made his historic review at a long span of time, while Zhou is superior in his contemporary investigation in the face of reality. Reviewing the developing process of rural reform and township enterprises, Zhou points out that, bud of ownership change had appeared at the early stage of co-operatives; peasants showed passivity and reluctance to the rural commune; cost of control laid on the state was increasing; the state had to readjust its policy incessantly. The reform started by peasants from the bottom has created new subjects of ownership. When peasant families, district cadres and local government unite together and contend with the state (central government), peasants would prevail over the latter. Consequently the original structure of collective ownership has changed and new private ownership has been created, a status locally legitimate at first and gradually becoming legitimate nationwide. The same reasoning might apply to the process of denationalization of state ownership. When certain structural chains of planned economy have been broken up, state-owned

economy would survive in an environment deteriorating day by day, and operating cost of state ownership would be continually increasing. Along with the development of non-state-owned economy, particularly when local governments, counting their own financial benefits and resting upon booming local economy, have been contending with the central government, denationalization of state-owned economy would gain its dynamo. The institutional negotiation, or, the social game-playing between both sides would lead to an adequate equilibrium point which determines the structure of property rights required by China's market economy. The prominent role played by local governments would manifest as peculiar features of China's market-oriented process, unlike other developed countries.

2.2 Since a generalized concept of transaction was made by Commons, the relation between government and other social sectors, considered as a sort of transaction, has been taking its part in the field of economic analysis. The school of public choice has furthered the economic analysis of public finance and public goods with its theoretical framework, while special situations confronting China's transitional economics would give rise to possibilities of new achievements in this area.

With the viewpoint of subjectism and contractualism, in a planned economy, the economic relations between various social sectors centered around the government could be viewed as relations of rights and contracts, with initial delimitations set by the government compulsively, not by negotiation and set-

ting among right-owners of the contract, and generally impermissible of transacting or reorganization. This kind of relation of rights does not refer to free economic rights in its original sense, but is really a kind of planned rights, restricted and dominated by the government, and bears the characteristics of "implicit contracts". For instance, the relation between the government and citizens (mainly township residents) is an implicit social contract. The individual citizen is the master of the state, but he has to subordinately adhere to the government. The government deprives him of the rights that ought to belong to a free citizen, and at the same time takes obligations to afford him education, employment, medical care, pension etc.. The economic background of this kind of social contract could be explained by socialist state-ownership of economic institution. The same is the case for the contractual relation between the state and state-owned enterprises. On one hand, the state as investor is the unique stockholder of the enterprise, on the other hand, the enterprise as production manager is an agent of the state. Direct intervention of the owner restricts freedom of behavior and space of choice needed by the enterprise, while the state is incapable of taking threat measures such as bankruptcy or terminating subsidies for the enterprise, i. e. , the state could not retain its property rights by means of "contract exit". Various economic relations inside an economy of public ownership could be explained in terms of such "implicit contracts". The goal of China's reform is to terminate the original "implicit contract", replace it by new "social

contract”, changing the roles of individual, government and enterprise.

The papers by Zhang Jun, “Socialist government and enterprise: An analysis in terms of ‘exit’”, has formulated a model of “exit”, giving a new explanation of the relation between the state and enterprise, and, by introducing an endogenous variable (Kornai’s concept of “soft budget restraint”) into his theoretical model, has deepened the empirical study for socialist economy. Lu Cang-cong’s papers “On managerial structure of corporation: Relation between the new and old ‘three committees’” discusses the contractual arrangements in conventional corporation, which involves meeting of stockholders, board of directors and board of supervisors, interrelating with the old board of party commissaries, board of staff representatives and the labor union. Sheng Hong, in his papers “Transitional economics of China”, presents a theory of transaction of planned rights, which might serve as an efficient implement for analysis of transition of various contractual relations during period of reform. The “triangular debts”, referring to contractual relations of credit and debit among banks and enterprises, is an economic and institutional phenomenon during transition. Ping Xin-qiao and Jiang Guo-rong in their papers have analyzed this “triangular debts” by means of theory of games, probing its cause of occurrence, mechanism of manipulation and mode of clearing, all backed by the concept of transaction of planned rights. One point needing notice is that, in the contractual relation with the government,

planned rights and planned duties sometimes are not clearly distinguished. A planned right under one condition might become a planned duty under other circumstances. A reasonable definition might be made such that, for a certain subject, planned right refers to benefit larger than cost, while planned duty refers to benefit smaller than cost. This would convenience analysis of transaction of planned rights.

2. 3 Generally speaking, the process of institutional choice and reform policy decision is one of collective action and public choice, in which the behavior of government and its officials, particularly malfeasance and corruption, would pose a serious problem. Becker and Stigler made their pioneering study of the problem, while Chinese economists, facing Chinese reality, have offered contributions in analyzing malfeasance and corruption utilizing methodology of modern economics.

Government officials participate in public affairs and policy-making, at the same time they are on commission or commissioning others. Malfeasance and corruption would likely occur. Moreover, a government official is also a rational individual, malfeasance or corruption is his rational behavior. So long as malfeasance or corruption would bring personal benefit larger than personal cost, malfeasance or corruption would likely be induced; on the contrary, so long as certain measures or arrangements would render personal cost outweigh his benefit, malfeasance or corruption would likely be curbed. However, probe into malfeasance or corruption would be at the ex-

pense of certain cost. When this cost outweighs prospective gain, the probe itself would be questionable of rationality. Consequently, scope of probing and penalizing would lie in an optimal range of choice, out of which it would be beneficial for malfeasance and corruption, neither would it be feasible for settling the problem. Malfeasance and corruption of government officials would most likely invoke public resentment. Poets emerge herefrom, yet could yield no explanation and solution. Yang Xiao-wei in his "Economic analysis of malfeasance" and Zhang Shu-guang in his "Economic analysis of corruption and bribery" conduct prudent and cautious investigations into this phenomenon, although frostily emotionless as it seems. Zhang Yu-yan's papers "Interest groups and non-neutrality of institution" gives an analysis of activity mode and behavior mechanism of interest groups, which might help further understand this problem.

In the market-oriented reform of China, a large part of public decision and public power are to be transformed into private decision and private power, via purchase, not via deprivation. Transacting power by money would characterize most of malfeasance and corruption. Supply cost of institution would be decreased by this kind of transaction, reform could be handled more easily. When new institution is established, it will create huge opportunities of public welfare. Hence, in the present situation, malfeasance and corruption are not only inevitable, but also lubricant for the reform. Cost paid in this regard actually constitutes the cost of economic reform. So,

we have been encountering a paradox like this: the reform would induce malfeasance and corruption, while the reform has to restrict it; the reform should forcibly curb and penalize malfeasance and corruption, while the reform would utilize it to alleviate resistance to power transfer and redistribution. Thorns and pits scatter everywhere; no perfect remedy could be found. A feasible choice might be auction, transaction of power by money being made public, market-oriented reform to be accomplished by commercialized measures.

2.4 Another fruitful field in 1994 is the innovative theory concerning development strategy and relation between reform and development. A book by Lin Yi-fu, Cai Fang and Li Zhou, *The China Miracle: Development Strategy and Economic Reform* presents a detailed discussion on relation between institutional change and economic development, based upon economic situations of China within recent years, giving priority to governmental choice of policy-trend. Fan Gang, in his papers "China's culture, rational institution and economic development", investigates the problem on basis of "Chinese economy" and "Eastern-Asia mode". Generally speaking, institution has its formal and informal aspects. By formal institution is meant written and compulsory regulations such as national law, governmental statute, corporation regulation and commercial contract etc.. Informal institution refers to traditional customs, morals and ideology consciously held by people, which could be generalized into the category of "culture". In the long run, the fundamental prerequisite for modern eco-

economic development lies in a stable institutional structure and performance expectation, necessitating a complete set of formal institutional regulations. Rise of the western world owes much to establishing and effectuating formal institutional regulations, prior to all others. Unlike the western culture, Chinese cultural tradition highly values "rule by men", not "rule by law", i. e. , highly values informal social relations and institutional arrangements, not formal ones. Success of overseas Chinese economy manifests itself as "enterprise familism", not "manager capitalism". In China during recent years of reform and development, many significant changes revealed itself as "foul plays" when formal institutional regulations had not taken any change. The "foul plays" altered behavior restraints of people, created new economic relations and profit-making opportunities, forming the China mode of reform and development. To a certain extent the success of "Eastern-Asia mode" owes to the stabilizing function of some external formal institution which makes up deficiencies of the Chinese culture. To further develop and modernize China economy, to carry forward China's cultural advantage, we have to enhance establishing and effectuating formal institutional arrangements. But Chinese culture, like Western cultures, has both advantages and deficiencies. Preciousness of Chinese culture lies in its universalism and globalism (Li Shen-zhi, 1994), its inclusiveness, compatibility and flexibility. If we combine merits of Chinese and Western cultures, especially, if we put laws prior to morals and advocate morals above laws, we might benefit from

welfare of economic growth while prevent disasters of demoralization and social crises.

Unlike Lin Yi-fu or Fan Gang, Wang Ding-ding in his papers "A review over economic development theories and reflections" presents a new theory. Economic development is viewed as a historical process. Starting from a certain "initial civilization", people while pursuing individual benefits make incessantly their progress both technical and institutional, and that is economic development, also the development of human being. The most prominent cost of division of labor is alienation of human being. In future domain of culture and technology, labor division and institutional evolution will tend to become non-specialized division and a more flexible institution. Then, main productive force will be human being, not machine. Intellectual property rights and human rights will be the core of interest. Overall freedom of individual, his creative activities in various fields will then become possible. Wang Ding-ding's synthesis of economic development theory bears a grandiose style, with impressive emphasis on the humanities.

Theoretical research of China's economics in 1994 has attained achievements in other fields. Hu Jing-bei's papers "An explanation of wages rise during economic development" formulates a first order model based on East-Asia development, and verified by empirical data from Taiwan. It expounds the so-called "Taiwan phenomenon", i. e. ,synchronized realization of growth and equity, furthering theoretical research in economics of development. Li La-ya in his papers "On relation be-

tween expectation and stochasticity", in line with Keynes, by means of Kalman's filtering, has found that in case of incomplete information of a stochastic process expectation bears its 'viscosity'. By introducing stochastic endogenous variable into his lattice model of rational expectation, he derives the relation between expected prices and stochasticity.

Besides, empirical analyses of China's economy have attained significant breakthroughs, e. g. , Zhao Ren-wei et al. , *A Study of Income Distribution among China's Residents*, Zhu Ling et al. , *Replacing Relief by Employment: Alleviate Poverty*. Numerous and fruitful explorations have also emerged in the fields of schematic design and policy making of reform.